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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 38

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.
Petitioner

v.

C. GORDON ANDERSON, TRUSTEE
Respondent

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR THE PETITIONER

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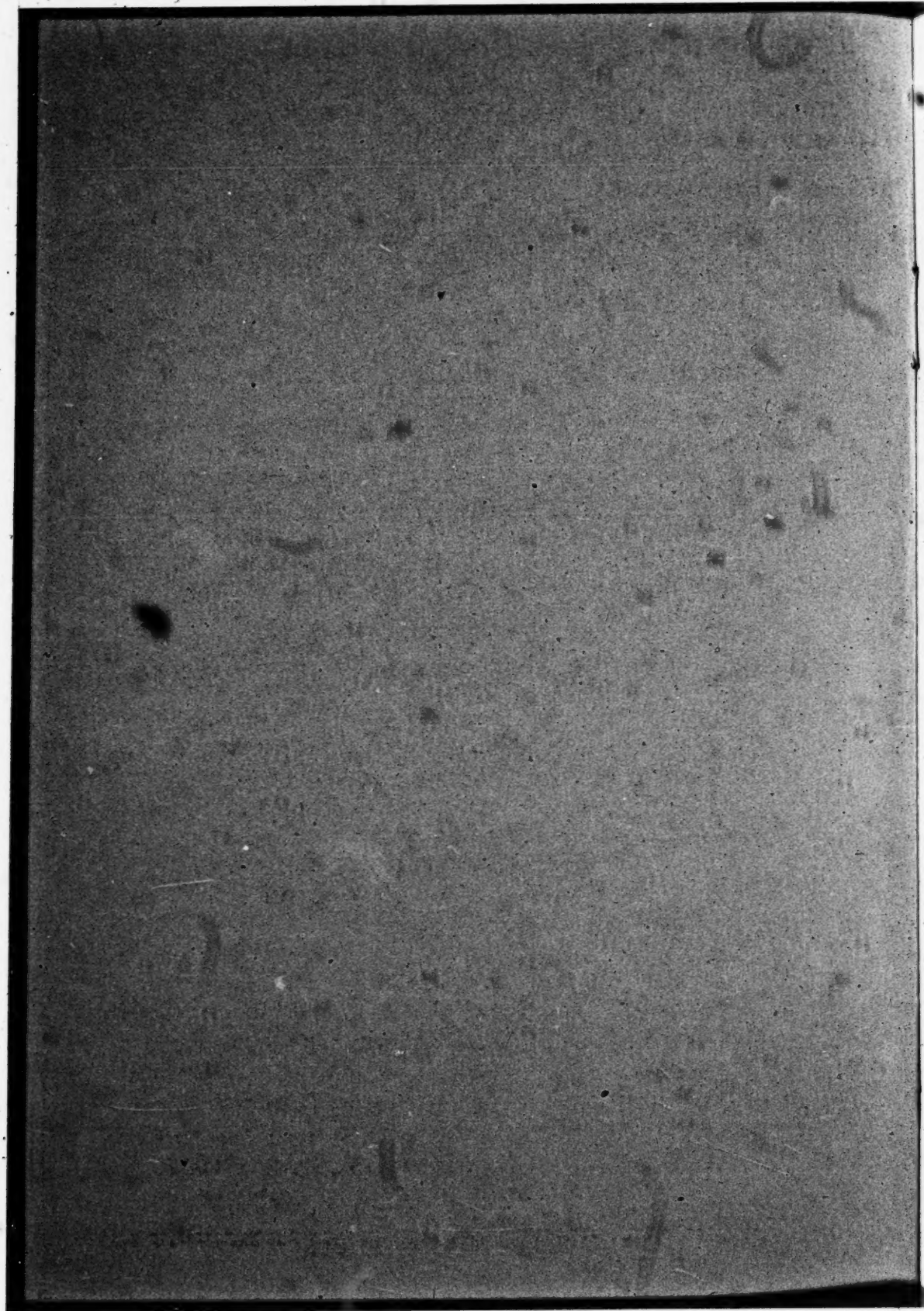

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The court of appeals opinion on the third (1965) reorganization plan now under review is reported 364 F2d 936. For its opinion on the first (1959) plan, 292 F2d 355, cert. (by a creditor) den. 368 US 956. For its opinions on the second (1962) plan, 334 F2d 111, cert. (by the trustee) den. 379 US 879; 334 F2d 118. Underlying district court opinions (III 260,387,389; II 370,387)* are unreported.

*Citation conventions: "III", the record, CA5 #22,652, directly involving the 1965 plan of reorganization; "I", the printed transcript

For still earlier court of appeals opinions unrelated to the reorganization plans, 256 F2d 416; 259 F2d 283.

JURISDICTION

The judgment of the court of appeals was entered August 12, 1966 (III 563). The petition for certiorari, filed January 9, 1967 (under extension order by Mr. Justice Black entered November 8, 1966), was granted May 29, 1967. This Court's jurisdiction is under 28 USC § 1254(1) and 11 USC § 47c (Bankruptcy Act, § 24c).

QUESTIONS PRESENTED

1. Whether a Chapter X reorganization plan must be set aside (a) because responsible charges of serious fraud committed by two major creditors have been refused on-the-record § 167 investigation; and because (b) the plan embodies compromises of these creditors' claims against the debtor and of the debtor's claims, setoffs and counterclaims against these creditors, entered into without on-the-record evaluation of the claims compromised, and in one instance without disclosure of the full scope of the compromise.

2. Whether a reorganization plan must be set aside as not "fair and equitable" under § 221(2) because valuation has been determined on past earnings history alone (a) in ex-

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record of appeals on the 1959 plan, CA5 #18,475; "II", the mimeographed transcript record of appeals on the 1962 plan, CA5 #19,996. By stipulation (III,403), I and II were incorporated by reference in III, and have been lodged in this Court under supplemental certificate. Order of this Court entered June 12, 1967 dispenses with record reprinting.

The order of appearance of documents in these three appeal records is not always the order of District Court filing; early filed papers sometimes appear only after later papers, or only in a later appeal record.

plicit rejection of this Court's doctrine that valuation be based on capitalization of predicted post-reorganization earnings; and (b) in consequent rejection of proffered evidence of business facts and reorganization facts tending to show a high immediately post-reorganization earning power of the enterprise; and (c) because even the past earnings history has been distorted by loading with heavy temporary expenses of reorganization and in other ways.

3. Whether public stockholders, who bought their stock in a market fraudulently manipulated by the debtor company in conspiracy with major creditors, may be refused creditor treatment in the reorganization, either (a) on the ground that they have no cause of action against the company as matter of law; or (b) as matter of procedure, on the ground of laches by a finding made without hearing notwithstanding the stockholders' contention was made of record over a year before the finding and three years before the plan now on appeal, and had been acknowledged by the trustee to be meritorious.

4. Whether a reorganization plan that contemplates that the trustee shall become president of the reorganized company must be set aside either

(a) as a matter of law, in that the sponsoring trustee thereby has an inherent conflict of interest that invalidates the required statutory finding that the plan is "fair and equitable" and that it has been promulgated by a "disinterested" trustee; or

(b) as a matter of fact, for actual conflict of interest, e.g., because the plan that puts him in the presidency rests on his compromises with two creditors charged with fraud, whereby the one creditor got a priority and the other got joint control of the reorganized company; or

(c) as a matter of procedure, because of the district court's refusal to allow on-the-record statutory investigation of charges that the trustee's attainment of the presidency involved improper "affiliations" and was therefore not "compatible with the interests of the creditors and stockholders and consistent with public policy".

STATUTES

The principal statutory provisions involved are §§ 167 and 221 of Chapter X of the Bankruptcy Act (11 USC §§ 567 and 621):

Sec. 167. The trustee upon his appointment and qualification—

(1) shall, if the judge shall so direct, forthwith investigate the acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business and the desireability of the continuance thereof, and any other matter relevant to the proceeding or to the formulation of a plan, and report thereon to the judge;

(2) may, if the judge shall so direct, examine the directors and officers of the debtor and any other witnesses concerning the foregoing matters or any of them;

(3) shall report to the judge any facts ascertained by him pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate;

* * *

Sec. 221. The judge shall confirm a plan if satisfied that—

(1) the provisions of article VII, section 199, and article X of this chapter have been compiled with;

(2) the plan is fair and equitable, and feasible;

(3) the proposal of the plan and its acceptance are in good faith and have not been made or procured by means or promises forbidden by this Act;

(4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge; and

(5) the identity, qualifications, and affiliations of the persons who are to be directors or officers, or voting trustees, if any, upon the consummation of the plan, have been fully disclosed, and that the appointment of such persons to such offices, or their continuance therein, is equitable, compatible with the interests of the creditors and stockholders and consistent with public policy.

STATEMENT OF THE CASE

This is a corporate reorganization under Chapter X of the Bankruptcy Act. The debtor, essentially sound and profit-making, came into bankruptcy court as a result of stock manipulations and frauds and of an accident at sea which appears to have been caused in part by the frauds.

Three successive plans of reorganization have been approved and confirmed, each over the objections of the stockholders committee and of the Securities & Exchange Commission. Each time the reorganization trustee emerged as president and director of the reorganized debtor, with a long-term contract and stock options firmly promised or transparently understood.

Each time control of the reorganized debtor went to the trustee along with one or another of the insider creditors who had participated in pre-reorganization and during-reorganization frauds. Each time the trustee's refusal to investigate protected an insider creditor and aided the trustee's personal ambitions.

Each plan wiped out several millions of dollars of public stockholder investment as worthless, by insolvency findings made otherwise than by the normal valuation procedure of capitalization of indicated earnings under post-reorganization conditions. This took place first without any valuation hearing and later by hearings confined to reorganization-period earnings. Each of the two later plans rejected without hearing the stockholders' claim to creditor treatment

based on stock frauds by certain of the insiders, disclosed by an investigation reluctantly made between the first and second plans. Each of the three plans provided new management selected without investigation of affiliations.

Pre-reorganization Background[1]

The debtor TMT Trailer Ferry, Inc., organized in 1954, pioneered the novel and sound concept of "fishyback" trailership transportation—roll-on roll-off transport of loaded highway trailers. The essential advantage of the system is that freight moves door to door overseas without rehandling. Initially TMT's trailership service was between Florida and Puerto Rico by barges (converted Navy LSTs) towed by rented tugs. A self-propelled Navy LSD was then acquired for conversion into a trailership. Maritime Administration guaranteed a $4,112,500 construction loan and permanent mortgage for the conversion of the LSD, the Carib Queen, under a statutory determination (46 USC 1274(c) that the operation was "economically sound". Early in 1957 the Carib Queen went into transatlantic service.

In December 1954 a small issue of less than 30,000 shares had been sold (with debentures for a total of less than $300,000) in compliance with the Securities Act of 1933, but in the following two and a half years some 4,000,000 shares of unregistered stock were issued for all kinds of consideration: to pay for ships, repairs and services, for bonuses and finders fees, to acquire stock of other companies, and sometimes for no consideration whatever. Of these shares not quite half were traced as having been floated to the public at prices of up to $4 per share through the hands of a

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[1] Except as otherwise cited, the facts of this "Pre-reorganization Background" rest on stipulation of Agreed Statement of Facts (I 21-43) and Trustee's Report (I 252-295).

group of insiders—Abrams[2] and Shaffer,[3] financial advisors to the company, and an associate, Erdman.[4] The paper assets of the company were increased by an exchange of stock with Bellanca Corp., arranged by Abrams at artificial prices which inflated by $800,000 the balance sheet on which Maritime Administration relied for the purpose of the Carib Queen loan guarantee. There were other shady Abrams transactions, including TMT's acquisition of wharf property at Wilmington, Delaware, for $1,000,000 above its true worth on the strength of an appraisal fraudulently procured over the name of a leading appraisal firm.

The illegal stock flotation and resulting large profits for the members of the group (over $240,000 established for Shaffer and his wife alone) were the product of an intense stock-selling campaign based on the "fishyback" method of transport, the launching of the self-propelled Carib Queen and the Maritime Administration guarantee.

The conversion work on the Carib Queen was done by Merrill-Stevens Drydock & Repair Co., ultimately the largest single creditor with claims totalling over $1,600,000 mostly for work on the Carib Queen. On the shake-down voyage there was boiler trouble (II 1055-6,1065-6,1099-1100;III 407-8). Merrill-Stevens had notice of the fact that the boiler water supply system left excessive oxygen in the water, and this made the boiler trouble that actually occurred, in its own word, "inevitable" (II 1062). Repairs were made

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[2]During the reorganization Abrams was convicted of contract fraud on the government and securities fraud in another company, I 258; Facts on File 1961 – 31D2; N.Y. Times Index 1964, p970; for related frauds by Abrams, *Ashbach v. Kirtley*, 289 F2d 159 (CA8,1961), *Kirtley v. Abrams*, 299 F2d 341 (CA2,1962), discussed infra p. 33.

[3]Shaffer was manager of a branch office of the reputable brokerage firm of Hirsch & Co. His transactions were partly in the name of his wife, Pauline Golding.

[4]Dr. Erdman was later convicted of bribing a federal judge in a bankruptcy case, N.Y. Times Index 1962, p510; ib. 1964, p510.

and the ship was released for her maiden voyage to Europe. In mid-Atlantic the boilers exploded.

In June 1957, Abrams and Shaffer knew bankruptcy was impending. They put together a group under the name of a strawman, Caplan, and furnished fresh money. (Caplan was later replaced by Shaffer and Spitzer so that the group is indifferently identified as the Abrams-Shaffer-Erdman or Caplan or Shaffer-Spitzer group.) They paid $280,500 for a $330,000 7-months note secured by a mortgage on the barges (plus 10,000 shares of bonus stock), and $49,500 for 49,500 shares of stock, market value then over $60,000. This short-term mortgage thus gave these insiders in the event of bankruptcy a strangle-hold on the only operating vessels. Within the month, on June 27, 1957, an involuntary petition under Chapter X was filed. The petitioner Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. entered the case under § 211 of the Act shortly after the proceeding started in mid-1957. The Securities & Exchange Commission, a party under § 208 of the Act and advisor under § 172, has been participating in the proceedings since November 1957.

The first Plan: control to Shaffer-Spitzer without investigation of fraud charges; stockholders eliminated without valuation hearing: – The insiders succeeded in using their eve-of-bankruptcy mortgage to gain control under the first reorganization plan. Ignoring his own objections to the mortgage as "usurious, unenforceable and void" (I 34), and brushing aside demands by the committee and the SEC for investigation of the frauds and of indications that the Caplan (Shaffer-Spitzer) mortgage group were fronts for the Abrams-Shaffer-Erdman fraudulent insiders (I 128-134, 179-181, 203, 463-467), the trustee "settled" with the mortgage group. The district court confirmed a plan of reorganiztion under which the Shaffer-Spitzer group, for its $280,500 payment, got all the voting stock of a company earning nearly that each year; general creditors received 17½ cents on the dollar out of one quarter of the earnings (I 163-5). The trustee became president and a director, with stock options (I 183, 198; II 525). The stockholders were wiped

out by an insolvency order entered without notice or hearing (Stip. I 34; 171, 444-5, 462-3). The Committee appealed, attacking the lack both of investigation and of proper insolvency proceedings (I 206).

Pending appeal, an interim trustee discovered a $100,000 under-the-table side deal by which Shaffer-Spitzer turned Merrill-Stevens' initial opposition to the plan into acceptance. His attempt to get the district court to vacate the plan as thereby violative of § 221 of Chapter X was unsuccessful although supported by the SEC, by a major creditor Tri-Continental Financial Corp., and by the committee (I 39-40,195-203;236). The district court refused to vacate the plan, removed the interim trustee and reinstated the prior and still-serving trustee (I 39-41).

The reinstated trustee, deriding as "frivolous" the committee's objections and appeal and pushing for immediate consummation (I 210,213), was confronted with affidavit proof presented by the SEC that Abrams and his associates were the owners of the Caplan mortgage[5] and were responsible for the Bellanca, Wilmington and other fraudulent transactions (I 216-230). At this point, reversing his course 180°, the trustee dutifully conducted an investigation of this portion of the frauds charged by the committee, fully corroborated them (I 252-295)[6] and moved to withdraw his own plan of reorganization as not fair and equitable (I 294-5;307-8,325-6). The district court granted the motion, Shaffer-Spitzer appealed, and the court of appeals affirmed. In view of the withdrawal of the plan the court of appeals considered the committee's appeal to have become moot,

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[5] Under various cover names, one of which was Bostwick Westbury Corp. whose address as given in the mortgage instrument was reported (correctly, it turned out) to be identical with Abrams' home address in Great Neck, Long Island. The committee had pointed out to the trustee and district court that this simple inquiry would corroborate the committee's charges of Abrams' connection with the mortgage but the trustee and the court refused to investigate (I 180).

[6] The trustee's report of this investigation is the report referred to supra n. 1 as record support for the opening pages of this brief.

and the proceedings returned to the district court for formulation of a new plan. *TMT Trailer Ferry, Inc. v. Anderson*, 292 F2d 455 (CA5), cert. (by Shaffer-Spitzer) den., 368 US 956.

The second plan: control to Merrill-Stevens without investigation of fraud charges; priority to Shaffer-Spitzer without remedy for proven fraud; stockholders eliminated by retrospective valuation: – The Merrill-Stevens claims arose principally out of services in the design and construction or conversion of the debtor company's vessels. The "Lloyd", designed and built by Merrill-Stevens, proved top-heavy and capsized (II 1069;III 410; but see 1098 ff); the "Georgia", converted by Merrill-Stevens, put to sea with open discharge lines and swamped (II 1068,III 409; but see 1098 ff); the "Carib Queen", converted by Merrill-Stevens under Maritime Administration guarantee, was released with defective boilers which exploded in mid-Atlantic (I 271;II 1045 ff;III 406-9, but see 1098 ff). Damages amount to millions of dollars (I 270).

Merrill-Stevens asserted an unsecured creditor claim of over $1,000,000 for balance due on the Carib Queen (foreclosed by Maritime Administration as guarantor, supra p. 6) and maritime lien against other vessels for $575,000–together $1,628,000 out of total creditor claims of $5,400,000 (II 23,288).

As early as November 1958, i.e., before approval of even Plan I, the committee had sought investigation of Merrill-Stevens responsibility for losses (I 130). The trustee filed what he later denigrated as "perfunctory" objections to the Merrill-Stevens claim (II 23). On February 3, 1959, neatly one day after the Shaffer-Spitzer $100,000 under-the-table purchase of Merrill-Stevens acceptance of Plan I (I 39, 200-3; supra p. 9) trustee's counsel announced at a special master's omnibus hearing on objections to claims that the Merrill-Stevens claim had been "accepted and settled out of court" (II 23-4).

After vacation of Plan I the trustee reported the claim as informally settled (II 621-2). The SEC objected and asked

for investigation on the ground that the trustee did not have enough information to arrange a fair settlement; that the claim was excessive, the work unsatisfactory, the Carib Queen not seaworthy (II 24,1094-5). The SEC detailed in Specifications the results of its own investigation. It concluded that defenses, offsets and counterclaim were available against the balance claimed on the Carib Queen; that Merrill-Stevens was responsible for damage and loss, including cancellation of a U.S. government mail contract because of construction and registration delay of the "Lloyd"; that reduction of claims against "Georgia" and "Carolina" was called for (II 25,862; III 405). Merrill-Stevens answered with a document of broad denial (II 1098), but no hearing on the Specifications was ever held.

Instead the trustee moved for full allowance of the claim notwithstanding the SEC objection.[7]

The U.S. government, a major creditor, also filed objections (II 647). The committee then submitted Specifications of its own investigation (II 1042-1072.4), charging negligence and contract breach, based on detailed analysis of the contracts, of the records, and of admissions made by Merrill-Stevens employes. The Specifications particularized the contract paragraphs, the evidentiary documents and the witnesses whose recorded statements are relied on, with names and dates. The Specifications also supplied evidence of Merrill-Stevens participation with the debtor and Shaffer-Spitzer in the marketrigging, including fraud on the Maritime Administration by Merrill-Stevens and the debtor in obtaining the highly publicized loan guarantee on the Carib Queen, and asked a master's hearing. The SEC advised the court that the burden of proof and of rebuttal was now on Merrill-Stevens and also requested the district court to order a hearing on the committee Specifications (II 1073-4). Merrill-Stevens made no answer; no hearing was ordered on these Specifications.

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[7]The effect of this capitulation is argued infra p. 28 ff.

Instead the Merrill-Stevens claim was "compromised" in Plan II by allowance in full to the penny—$1,628,284.40, after reclassification to unsecured position of the $575,000 lien, already under attack by the U.S. government as an invalid maritime lien.[8] Thus, by cumulation of its dubious claims, Merrill-Stevens became the largest (ca.43%) of the unsecured creditors, the class that got the voting stock, and so came into control (2 places on a board of 7)[9] along with the trustee himself and his general manager (II 297-8) and one of his attorneys (II 978,III 354). The remaining two directorships went to beneficiaries of the trustee's reorganization patronage (and therefore of his post-reorganization patronage, if they did not newly offend him). One was an official of the towing company[10] that held a sweetheart contract running to $1,500,000/year,[11] bestowed without fair opportunity for competitive bidding and at a price per voyage $1,000 higher than an actual bid received (II 946-954; III 94-6). The other was the trustee's insurance broker (III 353-4), like the towing family a heavy buyer of creditors'

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[8] In the circumstances of this reorganization, reclassification to unsecured was not a demotion but in fact, as the trustee's general manager admitted, a "privilege" (III 91). Florida Towing, with an undisputed lien claim, elected to make the same swap and for the same purpose, viz., to get a piece of control (II 878,879.3,987).

[9] The next largest general creditor, Tri-Continental Financial Corp. with $715,000 of claims, well over a seventh (cf. III 323), was not represented on the 7-man board.

[10] Florida Towing, one of three towing companies that did pre-reorganization work for the debtor, was originally a small lien creditor. With its principals the Coppedge family (II 917;III 353), it brought up claims and became a major creditor (II 879.3,354.10;III 317 ff). Florida Towing also supplied a loan commitment tied to the trustee's plan and "present management" (II 321) without which the plan could not be effectuated (II 313,320-3,903-4). The words of the loan commitment were later changed to "either present management (which is acceptable to us) or management of comparable calibre" (II 749-50).

[11] Towing is the largest single item of expense. See, e.g., II 219; III 76.

claims at large discounts (II 261,867,911,938;III 322). The trustee was again to be president and director (II 695,707, 978,987) with a long-term contract and formal assurance (or in later bowdlerized versions, practical assurance) of substantial stock options (II 274,276-7,296-9; 41.11)[12]

The committee's new and unanswered charges of collusion in marketrigging by the debtor and Merrill-Stevens bore on the Shaffer-Spitzer principals too (II 1066-7) since they were the active marketriggers, proven such in the early proceedings. Nevertheless the second plan embodied a "compromise" with Shaffer-Spitzer, that gave them a priority claim plus back interest plus a concealed immunity from suit.[13]

As in the first plan, the several million dollar stockholder investment was eliminated on an insolvency finding, though this time by a procedure that at least included a valuation hearing. Based on the conception that "the only reliable factors are what the debtor is doing now" (II 387.7), the court's valuation of $2,780,000 was arrived at by annualizing the trustee's then current (5-months) profit figure, deducting estimated taxes and capitalizing at 10% (II 387.5).[14] Before confirmation, two competing cash bidders had reached a level of $2,800,000, viz., more than the court's valuation, and indicated they were ready to go higher (II 865-6,876,880,911, 913,938,939). Essential information was excluded from the

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[12]The effect of such self-perpetuation by the trustee as invalidating the plan (Question 3, supra p. 3) is argued infra p. 62.

[13]The effect of this compromise (Questions 1 and 4, supra pp. 2-3 is argued infra, p. 29.

[14]The question whether the valuation technique which considered past earnings only, without consideration of an already existent current trend of increased traffic and of the trustee's already existent physical and financial programming to serve it at increased earnings after reorganization, departed from the standards laid down by this Court (Question 2, supra p. 2) is argued infra p. 42ff.

valuation hearings, and reported earnings were downwardly distorted.[15]

After the collapse of his first plan the trustee had proposed to prepare a new plan that would "satisfy the equities" indicated by the investigation (I 295); that as a result of TMT's securities laws violations instigated by Abrams and Shaffer (now d/b/a the Shaffer-Spitzer mortgagees) victimized stockholders were entitled to be regarded as creditors and in any case to participate ahead of Shaffer-Spitzer (II 1096). The trustee's report had showed the company's collusion with Abrams and Shaffer in securities law violations.[16] This led to the assertion by the committee, in proceedings looking toward a second plan but before remand on vacation of Plan I, that defrauded stockholders were entitled to be treated as general creditors (II 1037-42,[17] 1083, 1087, 1090;358,368).

No response was ever made to the Proof of Claim on this point filed by the committee; a motion to strike the Proof of Claim filed by an individual stockholder[18] on behalf of herself and her class of stockholders, which traced her shares of stock as having come through Abrams' hands, was never noticed for hearing (II 4,363,358,368). Nevertheless the district court's order approving the second plan summarily denied the claim in both forms without hearing, as insufficient on the merits, nebulous and too late (II 379).[19]

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[15] This aspect of the valuation is elaborated infra p. 55 ff.

[16] Including flotation of stock to the public through Abrams and Shaffer, publication of deceptive and grossly padded financial statements, improper transactions with Abrams and Shaffer, fostering of a speculative market by excessive publicity campaigns and other manipulations (I 260-286,288-9).

[17] The citation is to the committee's Statement of Position, served and proferred March 21, 1961; leave to file denied without prejudice to renewal (II 861,962); filed pursuant to leave as a rejected exhibit April 15, 1963.

[18] Irma S. Mason of the District of Columbia bar, of counsel on this brief.

[19] This question of the stockholders' right to creditor treatment (Question 3, supra p. 3) is argued infra p. 55ff).

The SEC supported both the principle of the claim and a right to hearing on the merits (II 1093).

The appeals from the second plan: – The committee appealed from confirmation of the second plan, asserting that this plan embodied the same aberrations of principle challenged in the first appeal but there left undecided, i.e., off-the-record compromise without on-the-record investigation of claims of insider creditors accused of fraud; grossly erroneous valuation technique. The committee also raised two additional issues arising out of the facts that had developed since the first appeal–the trustee's conflict of interest arising out of his interlocking alliances with the new control creditors; the stockholders' right to creditor treatment. The SEC again joined in the committee's appeal, taking as to the trustee the even more rigorous view that he was disqualified as president for prophylactic reasons quite apart from the actual proof of improper affiliations.

The U.S. as creditor also appealed because of denial of its absolute priority for certain non-tax claims. The court of appeals, sustaining the government, reversed and remanded. *United States v. Anderson,* 334 F2d 111, cert. (by the trustee) den. 379 US 879. Because a remand was thus necessary, the court of appeals again found it unnecessary to decide the issues raised on the stockholders' appeal except for advisory guidance on one point, that the trustee was not ipso facto disqualified from the presidency, although he would be "if the proponents of the plan assured him of emoluments and security", *In re TMT Trailer Ferry, Inc.,* 334 F2d 118,119,120.

The third plan: priority again to Shaffer-Spitzer and control again to Merrill-Stevens, the stockholders again eliminated; all by "law of the case": – Immediately on the opening of hearings on the third plan, renewing its charges against Merrill-Stevens, the committee asked for discovery of a group of documents that the trustee had earlier said he could not locate (III 19-20;85, cf.II 1072.3-.4). The district court refused this discovery on the ground that the at-

tack on Merrill-Stevens—and every other issue raised by the committee in the second appeal but left undecided by the court of appeals—had thereby been decided by the court of appeals against the committee, and were now the law of the case (III 85-87,264,350-1, 387-9).

As recited infra, p. 17, the court of appeals was to hold, on the committee's appeal from the third plan, that it had indeed contemplated no such thing as the district court attributed to it. But the district court's erroneous conception of the law of the case aborted the making of the record on the third plan: that court refused to consider the committee's demand for investigation of trustee affiliations (III 244-5;264) and confined the valuation proceedings to facts occurring since the second plan (III 66-7). Its new valuation found the debtor "more insolvent" than before without consideration of the committee's and the SEC's claim of error in the techniques used by the district court in both stages of valuation alike (III 266).

In a culminating application of the erroneous conception of law of the case—and in obvious pique at what the district court deemed the committee's obstructionism—the district court summarily discharged the committee for its recalcitrance in persisting in reraising this mess of issues the district court deemed closed; and so the denial of the committee's application for discovery of the Merrill-Stevens documents just mentioned was coupled with an oral order from the bench discharging the committee instanter (III 350-1, 387-9).

The trustee proposed and the district court accepted a third—the present—plan, differing from the second plan mainly in granting the government's non-tax claims a priority in the form of a cash payment of $904,000, financed out of a $1,250,000 new bank loan (III 25,107-8,347).[20]

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[20] At the time of the second plan the district court accepted the trustee's contention that cash payment to the government would

The third (present) appeal: – On the appeal from Plan III the court of appeals held that the district court's conception of the law of the case had been in error: the district court, in making the record and confirming the plan in disregard of the stockholders contentions, had incorrectly foreclosed "all those issues not in terms discussed and decided" in the earlier appeal, 364 F2d at 939. Nevertheless the plan was allowed to stand and the stockholders were left without remedy for the fact that this district court error resulted in presenting the plan for appeal on an erroneously aborted record.

The ground for the court of appeals action in so affirming in spite of the error was, that court stated, as to the stockholders' assertion of creditor rights, that it was within trial court discretion to set a bar date and find the stockholders in laches. On the compromises with insiders notwithstanding fraud charges, the court of appeals did not discuss the merits but found it "extremely significant that not a single creditor has ever complained of either compromise". It affirmed the insolvency determination on the ground that the district court's valuation mathematics was not demonstrated "clearly erroneous"; even if the $2,000,000 of the Merrill-Stevens and Shaffer-Spitzer claims were to be stricken the court of appeals thought it "extremely unlikely" that this would result in solvency. It did not discuss the committee's contention that this gap reflected only

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have made the plan of reorganization not feasible (II 373-4,765,825). The fact that the new bank loan requires debt service ($300,000 a year plus interest at 6%, or $366,750 the first year (III 347-8), in excess of the trustee's and the District Court's earnings estimates ($206,000 (II 387.3)) or $378,000 (II 387.5) on which valuation was based), is discussed infra p. 54, 62, as bearing on whether the plan is in good faith, and whether the trustee's earnings figures are realistic, and on the effect of the trustee's affiliations.

the erroneous rejection of evidence that this Court's decisions have required to be included and considered.[21]

In the light of the court of appeals treatment of the case as involving the presumption of correctness of trial court action unless "clearly erroneous" and of deference to trial court "discretion" there runs through all the specific rulings of the court of appeals a common question of essential fairness—whether trial court failure to permit the making of a record, on the issues of laches and valuation and fraud to say nothing of the tainting of the whole proceeding by a trustee's conflict of interest, is error too gross to be saved as within "discretion" or as "not clearly erroneous".

SUMMARY OF ARGUMENT

Petitioner is a committee representing public stockholders. These stockholders are, unless this Court intervene, to be deprived forever of any salvage for their investment of several million dollars in favor of the very persons they challenge as responsible for the destruction of their company. (Point I)

This results, in one major branch of the case, because the courts below found an unbridgeable gap between the minimum figure for claims, $3,400,000; and the maximum figure for the value of the enterprise (which in the year of the valuation, had revenue of $3,800,000 and profit of $655,000 before taxes). The district court fixed the maximum value of the estate at $2,780,000.

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[21] This contention (Question 2, supra p. 2) is argued infra p. 42 ff. On this third appeal the court of appeals did not discuss at all the retendered point of the trustee's emergence as president (Question 4, supra p. 3). The point is still open for review in this Court now, since it was the affirmance of the third plan that for the first time ripened the court of appeals own explicit but advisory second plan decision on that point. Stern & Gressman, *Supreme Court Practice* (3d ed., 1962) 18.

Valuation is an uncertain art at best, but it has standards. This valuation was based on rejection of all evidence of predictable higher revenue and predictable lower costs for the reorganized company, in explicit repudiation of this Court's standards requiring valuation to be measured by future earning power, e.g. *Consolidated Rock etc. Co. v. DuBois,* 312 US 510; and it was immediately proven fallacious. Even as the district court announced its $2,780,000 figure, responsible but uninvited prospective buyers in a brisk bidding that rose by small increments to successively top the trustee's and court's values, offered in cash more than the court's official valuation, and made clear that that was not their top figure.

These unsolicited bids demonstrated, by the test of the market place, the irreality of the district court's valuation. Confronted by this proof, the district court failed to reexamine his conclusions and failed to test out the level to which the market would go. It is inescapable on these facts that a valuation reliable enough to justify excluding the stockholders has never been made (Point II).

These errors do not stand alone. The trustee has refused investigation into pre-reorganization wrongdoing it was his statutory duty to expose. And he has made illusory compromises with the accused wrongdoers, surreptitiously agreed to abandon substantial causes of action against some of them, made alliances with them and with other major creditors that put control of the company into hands which the policy of Chapter X forbids, those responsible for the destruction of the company and discount purchasers of claims who used those claims to vote themselves into shares of control and post-reorganization patronage.

All this involved essentially application of what is now hornbook reorganization law. It has place on this Court's docket primarily because the multiple procedural violations by the trustee have been coupled with his flouting of the overall fiduciary responsibility imposed by the statute, *Wolf v. Weinstein,* 372 US 633, and because he has been encour-

aged in recidivism by the failure of the courts below to grasp the twice before offered opportunity to enforce that responsibility. These very issues were raised but not decided, on the committee's appeals from two earlier plans involving much the same complaints. (Points I and II)

The plan on appeal should be invalidated for two further reasons, which the case law has not so far brought before this Court:

First, stockholders who have been defrauded by a conspiracy, in which the company participated, to issue stock in violation of the Securities Act of 1933 and to float it to the public in a market manipulated in violation of the Securities Exchange Act of 1934, are entitled because of such violations to be treated in a Chapter X reorganization as creditors, quite apart from solvency. The facts were first disclosed in 1960 and the claim first asserted of record in 1961. The court of appeals avoided passing on this issue by disposing of it on the ground that it was raised too late. But this was in turn major procedural error, for the question of alleged lateness was one of fact and was disposed of without hearing. *Czaplicki v. The Hoegh Silvercloud*, 351 US 525. (Point III)

Second, the trustee's accession to the presidency under this strongly contested plan as under each of its predecessors establishes that it has not been promulgated by a "disinterested" trustee as the statute requires, and that the plan must therefore be vacated. We join the SEC in believing that a rule so excluding any trustee is a healthy one required by the policy of the statute. This broad question is not however necessarily involved in our case because, whether trustees generally should be so barred, this one must be. It is impossible here to disentangle the concurrence of his personal ambitions with his violations of basic reorganization protections. (Point IV)

In a case as long and as complex as this it is not feasible to pursue and analyse to the full each of the myriad issues that are involved. For that reason we shall necessarily treat

rather summarily many points individually worth close attention, pointing out only that, shocking though our charges are, they are in fact fully supported by the record; and through ten years of litigation and three major rounds of appeals, our positions on these points have been consistently supported by the only wholly expert, wholly independent, wholly disinterested party, the SEC. (Point V)

ARGUMENT

The reorganization process was house-cleaned in the nineteen thirties by a series of reforms designed to protect the investor interest against insiders and adventurers. The chief weapons were to be investigation and disclosure by an independent trustee, under the active control of the district court aided by an expert administrative agency, with representation of scattered security-holder interests made possible by fiduciary committees.

The spirit of the legislation was stated by then SEC Commissioner Douglas as follows:

> "There is a widespread and national interest in these reorganization proceedings. . . . The holdings are small and individual action by the stockholders to protect themselves is in many cases out of the question. They either lack the funds or the skill, the acumen or the initiative to take matters into their own hands. They are frequently without adequate representation in the proceedings. . . . They are at the mercy of the inside groups—management and bankers—. . . and these inside groups often have objectives which are incompatible with the objectives of investors. They are interested in concealing claims for fraud or mismanagement; investors are interested in collecting on these claims. They are interested in keeping the past a closed book; investors are interested in examining the past to determine whether or not the management has been incompetent or faithless . . . they are interested in reorganization profits;

> investors are interested in economy and fairness . . . . The problem becomes one of making it more probable that the investor interest will be ascendant and dominant and that reorganization adventurers will not exploit the proceedings for their own selfish objectives." *Hearings before H.R. Committee on the Judiciary on H.R. 8046* (75th Cong. 1st Sess.) p. 163-4.

Roughly thirty years later, the benefits of that reform need to be looked at again. This case affords a conspectus of the abuses recognized in the thirties, densely packed into a single record.

POINT I—The failure of the district court to require the trustee to make the investigations and disclosures required by Chapter X resulted in withholding from the record essential facts: in consequence, insiders were enabled to gain control of the debtor company and stockholders were unfairly excluded.

If Chapter X is to achieve its purpose, "Reorganization facts should not be shrouded in mystery." SEC, *Report on the Study and Investigation . . . of Protective and Reorganization Committees*, Part VII, p. 341 (1940). The Chapter X procedure was designed, notably in sections 167 and 221, to give assurance that the past would be investigated and not hidden and that parties to the reorganization would have access to the facts they need for intelligent appraisal of the future.

> "For the first time such information will be available to the court and the investors as a routine matter. On the basis of such information, the court and the investors can intelligently decide whether or not proposed plans are fair, equitable, and sound—whether assets are being wasted or overlooked; whether there is a complete accounting for the old venture before the new one is launched; whether the old management should be restored to power; whether the allocation of assets, earnings, and control are fair. Through an impartial trustee, such facts will be assembled and

appraised" (H. Rep. No. 1409, 75th Cong., 1st Sess. (1937), p. 43).

A. Investigation of pre-reorganization misconduct, required by Chapter X, was delayed or suppressed.

Certain investigations are mandatory. The trustee has not made them and the courts below have not required them.

Investigation of responsible charges of fraud is one of them. § 167(1) requires that the trustee investigate the "acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, and any other matter relevant to the proceeding or to the formulation of a plan." There is a special emphasis that he shall report the facts that he learns "pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate," § 167(3). No plan may be confirmed unless the judge is "satisfied" among many other things that § 167, as part of Article VII of Chapter X has been complied with. § 221(1).

At the risk of elaborating the obvious it should be remarked that this requirement that the reorganization judge be "satisfied" is not a formalism: it is intended to spur him to aggressive ascertainment that the standards of the statute have been met. 6 *Collier on Bankruptcy*, ¶ 11.02. The legislative history collected, ibid. ¶ 7.18, makes plain that although § 167 is discretionary in form—the trustee "shall, if the judge shall so direct, forthwith investigate"—it is normally mandatory in fact. Whenever a substantial question of fraud is raised, a searching examination is required:

> "The independent trustee should be authorized and directed to make an investigation in every case of the condition of the company and of the events antedating the failure . . . an investigation of the most complete and thorough-going character, with opportunities to examine under oath those who had knowledge of the corporation's affairs and with the institution of suits for recovery where probable liability had been shown, *to the end that all the processes of*

discovery provided by law might be fully used. This requirement was not met by the sort of examination which the trustees conducted", *Committee for Holders etc. v. Kent,* 143 F2d 684,686 (CA4, our emph.)."

"The duty of the court to direct the investigation of all substantial allegations of mismanagement and fraud is plain." *Re Phila. & Reading etc. Co.,* 105 F2d 354,356 (CA3)." See also *Gochenour v. Cleveland Terminals Blg. Co.* 118 F2d 89 (CA6); *In Re South State Street Bldg. Corp.,* 105 F2d 680 (CA7)

It was a failure of investigation that led to the vacation of the first (1959) reorganization plan for TMT. That plan had turned the company over to the Shaffer-Spitzer mortgage group, notwithstanding the committee had made charges that the group was a cover for the notorious Abrams who had been largely responsible for wrecking the old company. Trustee and district court declined to investigate, and the court instead confirmed the plan: the committee appealed. When the trustee insisted that the plan be consummated notwithstanding the appeal, the SEC presented a staff affidavit that corroborated the committee's charges. Only then did the trustee himself investigate, confirm the charges, withdraw the plan, and recommend remedial measures.

One would think the trustee had learned an important lesson.[22] But he did not learn it. He has never carried out

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[22] The lesson to be learned is best stated in his own language, quoted from his court of appeals brief in the Shaffer-Spitzer appeal (#18475) from vacation of Plan I, pp. 4,9,49,50: "The cause of these appeals is indeed unusual: the determination made by the trustee after a lengthy investigation that his plan of reorganization was not fair and equitable, and the court thereupon setting it aside so that he might come up with a better one for all concerned. * * * [T]hese proceedings [to determine the amount and priority of all mortgages and liens] were never had because the trustee and the lien claimants "agreed" as to the disposition of liens in the plan of reorganization. It is apparent now that it was unwise to proceed in such a hurry in an effort to get some kind of plan approved, by-passing the statutory provision for an investigation and

his own remedies as to Shaffer-Spitzer. Moreover, when a parallel situation presented itself as to Merrill-Stevens on Plans II and III, the whole process was repeated.

Twice plans of reorganization have been approved and confirmed giving control to Merrill-Stevens and the trustee (II 370, 881, 987; III 260, 328, 353) without investigation of challenges to the claim and responsible charges of misconduct and fraud. The committee initially charged negligence (I 130); the U.S. as creditor challenged the validity of the asserted maritime liens (II 647). The SEC made an investigation and specified defenses, offsets and counterclaim available against the entire claim; (III 405) these Specifications were met by a document of broad denial (II 1098). No investigation of counterclaims to Merrill-Stevens claims or setoffs and defenses has ever been made on the record. Unnamed assistants disposed of all these issues off-the-record on no basis more articulate than that Merrill-Stevens did not choose to yield to the trustee's request to compromise.[23]

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for a proper valuation proceeding in a reorganization of this size and complexity * * * [S]ubsequent events have justified the stockholder's position and that the plan of reorganization should not have been approved and confirmed without the formal trustee investigation contemplated by the Bankruptcy Act and without formal insolvency proceedings. * * *"

[23] The trustee's articles of surrender took the form of a motion, December 27, 1961, to allow the Merrill-Stevens claim in full:

"8. Efforts have been made by the Trustee to effect a compromise with Merrill-Stevens of the amount of its claim in view of the objections filed against it, but Merrill-Stevens has refused to make any compromise and insists that its claim be allowed in full. It is the opinion of the Trustee and of his undersigned counsel that further effort to compromise or settle this claim will not be successful.

"9. Two attorneys in the office of counsel for the trustee have examined the factual data gathered in the trustee's investigation of the objections to the Merrill-Stevens claim and it is the considered opinion of both attorneys that the possibility is remote of obtaining any reduction, or material reduction, in the amount of the Merrill-Stevens claim by litigating the objections filed against it. Trial of the issues

The committee, dissatisfied by this casual treatment, obtained leave of court for further study, and six weeks later filed thirty-odd pages of detailed Specifications resulting from its own investigation. (II 1042-1072.4). Here the committee reported additional items of negligence and contract breach, documented with specific evidence including identification of admissions by Merrill-Stevens and its employees.[24] The committee also reported strong indications of Merrill-Stevens' participation in the stockrigging conspiracy, including deception of the Maritime Administration. (II 1071-1072.4) The committee's Specifications stand unanswered in the record, although the SEC advised the court that these Specifications shifted the burden of going forward to Merrill-Stevens and that a hearing should be held. (II 1073). No hearing was ever held on them. The committee's specifications acknowledged a gap in its proof on the fraud issue because of lack of the file on the Maritime Administration guarantee (II 1072.2-.4) which the trustee advised he did not have (III 19-20,85).

The committee then made further diligent investigation, attempted fruitlessly to obtain an administrative ruling permitting or declining voluntary production of the Maritime Administration counterpart file; and when a ruling finally came down in November 1964 refusing to disclose the documents in the absence of a court order the committee applied to the district court in December 1964 for a production order (III 16). Production was denied (III 73,87). The committee by further effort then succeeded in pinpointing individual documents, contents, dates, and file numbers. Its renewal of the same attempt at discovery by Rule 36 request for admissions was also denied (III 310,346,351). Both de-

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raised by the objections would be time consuming and would result in unnecessary delay in formulating a plan or reorganization." (II 25-6)

[24] Thus, James Merrill confirmed that the turbines of the Carib Queen were not chemically cleaned, II 1054-5. Forbell of Merrill-Stevens admitted that the evaporator producing distilled water for the Carib Queen was inadequate II 1059. Merrill-Stevens acknowledged that, because of excessive oxygen content in the water, it "knew that boiler troubles of the type that occurred were inevitable" (II 1062).

nials rested on the pervasive and mistaken ground of law of the case, that precluded consideration of so many of the committee's contentions at the time of Plan III.

Lacking these documents the trustee could not have made even informal investigation of the committee's charge of collusion between TMT management and Merrill-Stevens. A conscientious trustee would have been ashamed not to follow up these leads. Proof of such collusion, apart from its impact on the question of future control, could benefit the estate in many ways. For example, it would allow recovery against the Shaffer-Spitzer principals for any damages the company suffered by actions of Merrill-Stevens pursuant to the stockrigging conspiracy, a matter of some importance in the event that Merrill-Stevens might not be able to respond to judgment (Cf. II 1066). The Specifications themselves had pointed out that such proof would also completely cut the ground out from under the only defense Merrill-Stevens had so far presented on the record to meet its admissions as to the Carib Queen—the notion that TMT management had known of the deficiencies of the vessel and had condoned them. (II 1062).[25]

In sum, then the decision not to pursue Merrill-Stevens, made before the committee Specifications were filed, took no account of substantial charges never denied, of significant admissions against interest, and of new documentation never examined by the trustee. Investigation and hearing on its challenged claim and on the fraud charge having been thus suppressed, under Plans II and III Merrill-Stevens and the trustee came into control.[26]

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[25] The committee's Specifications, however, had also met this defense on another ground, viz, that the construction contract had been so drawn as to preclude just such fuzzy parole proof of condonation, for it included the elementary requirement of any competently drafted construction contract, viz, a specific and detailed procedure of formal and written warning and disclaimer of liability by Merrill-Stevens to TMT (II 1051-2).

[26] Merrill-Stevens' control position is further discussed, infra, pp. 28-9.

B. Unfair compromises were made by the trustee with the two dominant creditors without disclosure of the true terms of one or the basis of either compromise.

Instead of investigating the fraud charges as to the Merrill-Stevens claim the trustee disposed of the claim by purported compromise in both Plan II and Plan III alike.

The "compromise" allowed the claim in the full amount, $1,628,284.40, with no discount at all for the indicated defenses and counterclaims for negligence and contract breach nor for the wholly uninvestigated question of fraud. The only modification between claim and plan treatment was that, on the one-third or so of the claim, $575,000, for which it asserted a (disputed) maritime lien, MS waived priority.

While this reduction from lien rank to parity with general creditors might serve as the traditional peppercorn to make consideration for a bargain, this does not make the deal any less of a surrender by the trustee. In the first place, the $575,000 face value figure for the lien claim was never its enforceable value for lien purposes: it was secured by assets having a value of less than half the total lien claims against them (II 7, 736-7), as the district court recognized (II 372), so that the resulting deficiency of more than half the $575,000 could not hope to get more than unsecured status under any possible marshalling. At that, other creditors had advanced detailed objections to the validity of the lien on grounds of maritime law, and these issues had never been examined (II 636,647,648-9).

What destroys any claim that this deal might have to recognition as a compromise in good faith, however, is the fact that when Merrill-Stevens swapped the lien claim for general creditor status it not alone sacrificed nothing real but gained something very real – control. Merrill-Stevens thereby became overwhelmingly the largest single general creditor, increasing its fraction of that class from less than 30% to over 40%. Since it was general creditors that got

the voting stock, and the remaining general creditors were sufficiently scattered that no three of them could now outvote it (III 318), Merrill-Stevens now had initial working control of the reorganized company. Merrill-Stevens' reclassification was thus not a demotion but in fact a "privilege" (III 91).[27]

Paralleling this compromise with Merrill-Stevens, the trustee made an equally inexcusable deal with Shaffer-Spitzer. The charges against Shaffer-Spitzer had been proven by the trustee himself: its claim, he had found, was grounded in fraud, was subject to defenses and counterclaims, the unmasked wreckers behind the mortgage were to be subjected to suits to account for their profits,[28] and the mortgage itself subordinated to all other interests including stockholders. (I 282 ff; II 1096). It was and is indisputable law that a creditor claim by a faithless insider must be subordinated to the claims of all other creditors and of stockholders too. *Taylor v. Standard Gas etc. Co.*, 306 U.S. 307.

Yet with no record of so much as a suggestion why that law did not obviously apply to these facts, the "compromise" scaled the Shaffer-Spitzer claim down by only the amount of the initial – and unconscionable, whether or not technically usurious – discount between the $330,000 face amount of their mortgage and the $280,500 cash they had paid the company for it (and for 10,000 shares of bonus stock then selling at $1.25 per share. I 275,286) and even the loss of dis-

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[27] Supra p. 12 n. 8. We discuss below p. 62 the conflict of interest that arose from the fact that not alone Merrill-Stevens but everyone else represented on the new board was beholden to the trustee, and he was beholden to them for the presidency.

[28] Shaffer's net profits alone amounted to over $240,000 (I 281).

count was more than made up by allowance of "back interest" from 1958 accruing at $16,000 per year, an allowance that was given to no other party to the reorganization, not even to creditors with undisputed maritime liens (I 275,286; II 289,384). Setoffs and counterclaims earlier asserted by the trustee were put aside; while a suit was started against Abrams and others for procuring the false appraisal of the Wilmington property, other suits on the stock frauds affirmatively recommended by the trustee himself (I 289,291,294) to be brought against, e.g., Abrams, Shaffer and Erdman, were not.[30] Not until Plan III proceedings three years later in 1965 (with statutes of limitation running all the while) did trustee's counsel for the first time admit that utter abandonment of these suits, (although it never appeared on the record), had been part of the Shaffer-Spitzer mortgage compromise then "settled in the plan of reorganization" (III 192). Not a word of this appears in either Plan II or III, or in the proceedings on Plan II. Both plans expressly reserved all causes of action other than those stated to be settled (II 709, III 259, 273). When creditors' counsel inquired on the point, he was fobbed off (II 935-6).

In addition to this patent lack of substantive merit in the two compromises, and the lack of timely disclosure that the Shaffer-Spitzer compromise included a sweetener by way of abandoning TMT's rights against the Shaffer-Spitzer principals, they involved still another defect: there was no record disclosure of the basis for either compromise. When the trustee was given an opportunity to state the basis of the Shaffer-Spitzer deal, he testified only that it resulted from

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[30]Cf. judgment for $406,250 obtained by Chapter X trustee of another Abrams-wrecked corporation, *Kirtley v. Bankers Life etc.* 198 F Supp 30 (S.D.Iowa) reversed as to exemplary damages only, 307 F2d 418 (CA8). Other substantial benefits for the estate have resulted from investigations: reduction of debt from $5,200,000 to about $3,150,000 and subordination of insiders claims, *In the Matter of Texas Portland Cement Co.*, 205 F Supp 159 (E.D.Texas).

a conference in chambers.[31] Thus he supplied not the imperative why but only the collateral who and where. As to the Merrill-Stevens deal the trustee's answer was to quote, from a SEC letter not otherwise in the record, a short mention of proof difficulties as to some of the SEC objections and a statement that some compromise might be in order.[32]

But this is far from either a recommendation by the SEC of the terms of this particular compromise or a disclosure of the reasons why the trustee adopted those terms. Moreover his answer dealt only with the SEC's own objections. It did not touch at all the committee's independent, separately documented, further-reaching and later-filed attack on the Merrill-Stevens claim. This the trustee never attempted to answer.

[31] "Q: Regarding the alleged compromises of the Shaffer-Spitzer mortgage claim, and the Merrill-Stevens claims, as provided for in the Creditors' Plan, could you give us some indication as to the basis of those compromises?

A: I will be glad to. I will be glad to.

* * *

Q: Would you answer the portion of my question directed to the compromise of the Caplan mortgage claim?

A: The compromise of the Caplan claim was worked out between the attorney for that group, my attorney and myself. It was done in a conference the three of us had with the Court. It was completed after considerable deliberations and negotiations. It was submitted to the Court and approved by the Court and that is the way we came about to reach that conclusion." (II 283-4)

[32] "I have been summarizing their [SEC] objections to the Merrill-Stevens claim. I quote:

'We will be noted here, some of the objections are based on technical engineering facts which would require expert testimony as proof. Other objections are based on circumstances which occurred in 1956 and 1957 and their proof would require the testimony of individuals who witnessed the events.

'We believe, therefore, that to the extent possible, it would be helpful to reach an agreement with Merrill-Stevens.'" (II 284)

The trustee's and the district court's erroneous assumption that the trustee had no obligation to disclose what underlay his recommendations is illustrated by the trustee's earlier proposal for allowance of the Merrill-Stevens claim in full amount. We have quoted that document, astonishing because purely conclusory, at p. 25 n. 23. But § 167 requires that the trustee "shall report to the judge any *facts* (our emphasis) ascertained by him pertaining to frauds, misconduct, mismanagement and irregularities, and to any causes of action available to the estate." Facts, not opinions.

No facts about these compromises, other than those just reviewed, appear in the record. The district court's approval order indeed copies almost verbatim the trustee's nebulosities of ex parte opinion (II 373).

Thus both the trustee's recommendation and the district court's acceptance of the Merrill-Stevens compromise, discounting to zero some 35 pages of detailed and unanswered committee Specifications of holes in the Merrill-Stevens claim,[32] rested ultimately on the fact that two unnamed backroom-boys in the office of trustee's counsel had made an unrecorded examination of unspecified evidence presented long before the committee's tender of its Specifications; and the trustee reported and the district court accepted their unamplified opinion that litigation with Merrill-Stevens was unlikely to result in any material reduction in the claim.

If binding force is to be given an alleged compromise, there are standards of open disclosure that must be met. They are spelled out in General Order 33, applicable to reorganization by General Order 52(2). The requirement is that the appli-

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[32] In granting permission to make this investigation, the court had remarked:

> "I am concerned myself. I do know that whoever turned that vessel loose with the boilers in it, somebody made a bad mistake. I don't know who it was. * * * Everybody knows about the Merrill-Stevens' claim and the bulk of it is that those repairs were not properly made and resulted in a boiler breakdown, which caused all the main trouble, at least." (II 36-7).

cation for compromise approval shall "clearly and distinctly set forth the subject matter of the controversy, and the reasons why it is proper and for the best interest of the estate that the controversy be so settled." Interested parties must be advised of the facts fully enough to act intelligently, and it is the trustee's duty to see that they are. *Matter of Natl. Public Service Corp.*, 68 F.2d 859 (CA 2), cert. den. 292 U.S. 641.

In re Associated Gas & Elec., 61 FSupp 11,15,18 ff., aff'd 149 F.2d 996 (CA2) is the exemplar for successful compromise in reorganization. There the compromise was developed in open negotiations with SEC counsel present,[33] was referred to a special master, who conducted hearings and submitted a report which was itself the subject of court hearings.

Indeed we do not think there exists any reported case sustaining district court approval of "compromise" on such flimsy counterfeit of trustee's report as here. The uniform test of the reorganization compromise cases is that the record must show on its face enough information as to the controversy to be settled, the strengths and weaknesses of the opposing contentions both legal and factual, that court and parties can make firsthand "informed and independent judgment", in the phrase these cases quote from *Nat'l Surety Co. v. Coriell*, 289 US 426. The compromises in the present case may be measured against the extensive detail that was found in *Ashbach v. Kirtley*, 289 F2d 159 (CA8), a case involving the same Abrams who lurked here behind the Shaffer-Spitzer claim, to be "not sufficient information" to make such a judgment; or the even fuller detail that was found in *Conway v. Silesian-Amer. Co.*, 181 F2d 201 (CA 2)

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[33] By contrast in this case, a creditor-stockholder negotiation in the presence of SEC staff drew a district court reprimand to the SEC (III 378-9) for attending the negotiation at all, and the court's gratuitous and erroneous (cf. affidavit III 399) suggestion that the thrust of the negotiation was to buy off counsel for the committee without paying off the stockholders.

to leave "too many questions unanswered", resulting in "a lack of sufficient proof of the adequacy of the settlement proposed to justify acceptance of the plan as fulfilling the statutory standard." (at 201). Surely this trustee's few lines of off-the-cuff opinion of troublesome litigation in prospect, quoted footnote 23 above, do not meet the test of these cases.

Perhaps the most explicit guide to the requirements for reorganization compromise that the trustee here failed to meet, is *In re Chicago Rapid Transit*, 196 F.2d 484 (CA7), where a trustee proposed to compromise a creditor's claim and the company's counterclaim by roughly splitting the difference, and the district court approved. The court of appeals stated the question of the case to be "whether a reorganization compromise" . . . solely on the basis of expediency and the desire to forestall further lengthy and expensive litigation, with no attempt at considering the relative merits of the conflicting claims of the parties" (at 485) is thereby invalidated. Reversing, the court of appeals commented that the trustee "should be required to state his reasons for his lack of confidence in the analysis of his own accountant" (at 491), comparable squarely here to the trustee's lack of confidence in his own on-the-record analysis of the Shaffer-Spitzer claim:

> "The * * * Court * * * was in duty bound to ascertain the merits of [the creditor's] claims as well as the probability and merit of the trustee's claims against [the creditor] * * * We think there can and should be a reexamination – or rather an examination of *the legal and accounting theories* which give rise to the conflict in claims, *without necessarily going into the actual evidence* on the accounting. Such an examination of the underlying reasons for the conflict should furnish some basis for consideration of the fairness of the proposed settlement and whether or not it would be in the best interests of the debtor estate * * *", (ibid, our emphasis).

Passing for the moment both the lopsidedness of both compromises and the fact that from the Merrill-Stevens compromise springs joint control of the reorganized company in Merrill-Stevens and the trustee himself,[34] what is obvious from this case law is that the trustee has failed in his duty of disclosing the legal and factual basis for reversal of his earlier position of objection to both claims. Short of demonstration of the death of key witnesses or the disappearance of key papers or the overruling of key case law previously relied on it is difficult to see any excuse for his panic flight. He has simply not provided the information to meet the compromise requirement that he supply all the raw material necessary for the court and the parties to exercise firsthand that "informed and independent judgment" that *Coriell*, supra, 289 U.S. 426, 436 requires.

The trustee's failure to present the facts of his deals with Shaffer-Spitzer and Merrill-Stevens in the fashion which might have lent to them the guarantees of openness whether by separate compromise under GO 33 or in connection with a plan, is only another aspect of the multiform error injected into this case by the failure to discharge the duty of investigation and disclosure under § 167. Cf. *Consolidated Rock Co. v. DuBois*, 312 U.S. 510, 523 (1941), where the nuisance and delaying effect of litigation to determine the validity of the debtor's claim against an insider was urged, as in the case of the mutual claims involved in *Chicago Rapid Transit*, supra. p. 34, as ground for stomaching as compromise the treatment accorded that insider. This court rejected the attempt to justify the unjustifiable:

> "The fact that the claim might be settled, with the approval of the Court after full disclosure and notice to interested parties, does not justify the concealed compromise effected here through the simple expedient of extinguishing the claim".

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[34] This feature of the reorganization (Question 4) is argued below, p. 61 ff., p. 35 n. 34.

Moreover, it should be adequate answer to any claim that an insider's bargain embodied in a reorganization plan is thereby sacrosanct as compromise, to note that the *Deep Rock* case, a foundation of the last 25 years of reorganization plan law, itself set aside a compromise plan. *Taylor v. Standard Gas and Electric Co.*, 306 U.S. 307, 312, 323.

C. Investigation, required by Chapter X, of affiliations of new management, of payments made or promised, and whether the proposal of the plan and its acceptance are in good faith and not procured by means or promises forbidden by the Act, was ignored.

Mandatory also is investigation of the affiliations of new management (Sec. 221(5). These must be fully disclosed, the appointments must be "equitable, compatible with the interests of the creditors and stockholders and consistent with public policy."

> "Courts have been too prone in the past to take into consideration claims on the assets and claims on the earnings but not the allocation or disposition of control." Commissioner Douglas, *Hearings before H.R. Committee on the Judiciary*" on HR 8046, 75th Congress, 1st Sess. (June 1037) p. 169.

The statute requires that the judge be "satisfied" that such matters have been fully disclosed. The statute does not mean satisfied as with a placebo.

This history of Plan I should have itself demonstrated that it was, in the statutory words, "against public policy" to allow Merrill-Stevens representation on the board, without refutation of the charges that they had participated in prereorganization wrecking of the company and prereorganization stockpushing fraud. It does not take elaborate legislative history or case law to find in the term "public policy" the conception that people responsibly accused of fraud do not belong on the board of a publicly held company: the Plan I experience with Shaffer-Spitzer, dominating the Plan I board in the face of uninvestigated fraud charges, is itself the aptest precedent.

In still another direction the Plan I experience afforded a warning disregarded. Merrill-Stevens had then demonstrated itself not above participating in plan dealings not "in good faith" and by "means or promises forbidden by this Act." This had occurred when Shaffer-Spitzer bought Merrill-Stevens' consent to Plan I by agreeing that after consummation it would take off Merrill-Stevens' hands for $100,000 cash (a $50,000 bonus price) a block of new preferred stock that Merrill-Stevens was to receive under that plan for some of its claims, an offer that was made to no other creditor and that turned Merrill-Stevens' blocking opposition of Plan I into acceptance (I 39-41,198-200,236). It cannot be said with certainty that the trustee's abandonment of his threatened investigation of the Merrill-Stevens claims, ("accepted and settled out of court," he reported: II 23-4), just one day after the bargain with Shaffer-Spitzer was struck, (I 200-203) was contribution to the deal. But the episode at least should have alerted even a very naive trustee to be suspicious of the good faith of plan votes by major creditors with inside connections.

Two such votes on the new plans clearly were not above suspicion.

In the second and third plans, decisive votes were cast by the Florida Towing-Coppedge group and by Salley, trustee (II 878,879,902; III 316 ff; cf II 755). Salley was trustee for Langston and others, unidentified at the time of the second plan (II 917,938), but at the time of the third plan Langston was disclosed to be the trustee's insurance broker. (III 353-4). Langston and Coppedge became members of the new board (II 987, III 353-4). Florida Towing had originally had a small lien claim. Salley or Langston apparently none at all (II 558, III 317,322). By the time of the third plan they had acquired or controlled claims that gave them the statutory controlling voice in two classes of priority creditors: 70% of class 6 (III 317; cf II 682,755,795,902); 100% of class 7 III 318), and a substantial and important voice in the unsecured class (III 320,322,323).

During the reorganization the trustee had made Florida Towing the beneficiary of the largest single contract in the TMT operation, to move the barges between Florida and Puerto Rico, amounting to about $1,500,000/year, latest figures in the record, at a price that was more than $100,000 per year in excess of a competitive bid.[35] Florida Towing, at the time of Plan II, had offered TMT a $100,000 loan, critical to feasibility (II 313-14,319-22,833,835,837-38), expressly conditioned on the retention of the trustee in management (II 319-22, 837; fudged 750).

Nearly all these insiders' claims had been bought during reorganization at heavy discount ((II 867,911,932, III 317 ff.).

The discount claim purchases by these members of the new control group, beneficiaries of the trustee's patronage during reoganization (and so presumably after the reorganization), were clearly within the scope of § 203, which provides:

> "If the acceptance or failure to accept a plan by the holder of any claim or stock is not in good faith, in the light of or irrespective of the time of acquisition thereof, the judge may, after hearing upon notice, direct that such claim or stock be disqualified for the purpose of determining the requisite majority for the acceptance of a plan."

Its purpose, as disclosed in the legislative history, is to frustrate the person who buys up claims at default prices in order to sit in a strategic position to exact "some particular preferential treatment, such as the management of the company", or, as here, a key share in management plus lucrative reorganization patronage. SEC Commissioner Douglas, *House Hearings on HR 6439, 75th Cong., 1st Sess.* (1937) quoted in *Collier on Bankruptcy*, ¶ 9.21"

"When a purchase is in aid of an interest other than as a creditor or stockholder, such purpose may amount to *bad*

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[35]The effect of this contract on valuation is treated infra p. 48.

faith." Matter of P-R Holding Corp., 147 F.2d 895,897 (CA 2, our emphasis). Nevertheless, although the point was raised both specifically in terms of claim-buying under § 203 and generally under § 221 (4,5) in terms of the need for investigation of affiliations of Coppedge and Langston (II 261; III 245-6), no investigation took place; the district court declined (III 264) although asked (III 245-6), to investigate. Nor was there any compliance with the committee's reminder that the remarkable bank loan discussed infra p. 54 also needed looking into.

Investigation is called for when the judge knows that persons close to the trustee and who will serve on the new board and will vote on his election to the presidency and his salary and stock options, (a) have bought claims at a discount during the reorganization, (b) hold lucrative and substantial contracts from the trustee, and (c) have offered the trustee loans which were essential to the feasibility of the plan and were conditioned on the trustee's retention in management. These things, the district court suggested, do not amount to proof of wrongdoing (III 264). They do amount to proof that, assuming wrongdoing was absent, a court whose trustee had erred as badly as this one had in Plan I was required by § 221 to be alert to enforcing the fullest disclosure, when the trustee's personal ambitions were implicated.

D. Essential valuation facts were withheld by the trustee.

Valuation facts have not only been withheld from the record, they have been withheld from the parties and others entitled to them. Creditors and outside bidders as well as the committee and responsible interests brought in by the committee were frustrated in the development of reorganization plans and in establishing the true value of the enterprise by the withholding of essential information. II 71-2,240,244,

245,246,248,310.49-.51,929,930,951,954) Towing bidders were similarly diddled[36].

Information the trustee had prepared was refused in a way that not only defeated serious study but advertised that outside investors were not welcome. One instance of this is disclosed in the record in detail. If the estate is to be properly valued, or if fresh money is to be raised for possible rehabilitation of the enterprise, it is not enough to know the gross revenues or net earnings, even the true net earnings. A serious business inquiry calls for much more detail: the actual utilization of existing capacity, the point at which capacity would be fully utilized so as to make appropriate additional capital investment, the sales mix (Cf. *Villers, Dynamic Management in Industry*, 1960, ch. 14):

Although information as to the extent of utilization of TMT's capacity was already a matter of public record (II 80-1,96,97,178-9,230-9), the trustee refused to supply it to the committee or to a knowledgeable responsible investor who had tentatively valued the company at more than the trustee then said it was worth (II 96-7). Both before and at the valuation hearing, the trustee denied that this information existed in any form (II 94-5), then claimed it was a trade secret (II 95-6), then claimed the committee already had the information and should not want to know so much (II 97). The information sought was vital because the trustee claimed (and the district court accepted the assertion, precluded cross-examination on the subject, and based his valuation analysis on the contention) that the ships were already carrying their maximum (II 224-5; 70-2, 387.3-.5). In fact, there was substantial free space and free tonnage to carry

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[36] When the committee produced prospective towing bidders, majors in the industry (II 951,954), the trustee violated the district court's instruction to supply copies of the draft contract to bid against (II 929,954) and the general manager inadvertently disclosed that the negotiating atmosphere was so bad that one of these bidders broke off negotiations and would only deal direct with the court: this firm was still willing to bid, but it would not deal any further with this trustee (II 945).

more freight at less cost (II 179,230-9; cf. 1078-9). An investor who is refused the detail of this information knows he is unwelcome.

This illustrates the refusal to disclose. Active concealment took place when the trustee insisted on valuing the enterprise as a 3-ship business, refusing to discuss as too speculative the consequences of 4-ship operation (II 107-8; cf. 77,82,225,310.36-.38, 1079-82,1083), but failed to disclose that for some time before the hearing he had been actively in the market for a fourth ship which he actually bought before the conclusion of the approval and valuation hearings (II 310.1,310.13,310.44,357,865,876).

Refusal to investigate (or if he investigated, failure to report, we cannot know which) is exemplified by the lack of response to the committee's assertion based on specific investigation of the market that ships we said were needed were available in the market at prices the estate could afford and could finance (II 1079-1082). The trustee made, so far as the record shows, no investigation of these specific leads and did not divulge calculations he had in fact made as to projected earnings realizable from new ships and new kinds of ships (II 82,107-8,310.34, II 61-3, 144-148,150). Similarly, calculations of the portion of overhead allocated to the reorganization were made but not furnished (infra p. 49), and interim earnings figures needed to cross-examine on whether an upward trend was ending (it was not, II356) were refused II63-4)

This perseverated pattern of failure to make and refusal to direct required investigations and disclosures fatally impairs the plan on appeal.

These violations, we say, are not several. Woven together, they make up the fabric of this reorganization proceeding. The lack of investigation in this proceeding is not minimal error. The failure to investigate may deprive stockholders of greatly increased assets or saddle the stockholders with exaggerated claims against the estate – may even cause an appearance of insolvency and hence elimination of stock-

holders from participation. When the charges that are denied investigation are of misconduct and fraud, and because uninvestigated, control is or may be thereby given over to the hands of wrongdoers, the injury to stockholders is great and the perversion of the policy of Chapter X is clear. When suppression of investigation appears linked to the trustee's position in the reorganized company, the injury to the public is even greater for it is deprived of the protection of a system of impartial administration.

When full disclosure is not made of compromises, the power of intelligent decision is lost; when abandonment of suits and substantial counterclaims is an undisclosed term of the compromise, the injury may be crucial to the financial health of the estate.

Investigation and disclosure are tools for the protection of the public – whether it be of causes of action or affiliations of officers. Failure of this statutory duty, especially where responsible charges are made, even more especially where fraud is charged, becomes crucial when connected with control by insiders on the one hand and when used as a tool by a self-serving trustee on the other hand.

POINT II: Stockholders were excluded from participation in the reorganized company by an insolvency finding based on a valuation at odds with controlling standards set by this Court.

The question of valuation must be discussed primarily on the basis of the 1962 plan proceedings because, as we shall show, the district court erroneously failed to look afresh at this matter in 1965, taking the position that the correctness of its views had been, although the court of appeals later held otherwise, sustained in the appeals from the 1962 plan.

The district court held in 1962 that the company would not "necessarily" benefit from the growth of its market (II 387.4). The crux of the valuation error is precisely this misstatement of the issue. The issue is not whether the company would "necessarily" do so, for "a prediction as to what will occur in the future, an estimate, as distinguished from

dated Rock Prod. Co. v. DuBois, 312 U.S. 525, 526. On the issue of solvency arising in connection with reorganization plans "the commercial value of property consists in the *expectation* of income from it." *Galveston, H & S.A.R. Co. v. Texas*, 210 US 217, 226; *Consolidated Rock Products Co.*, at 526. "The basic question in a valuation for reorganization purposes is how much the enterprise *in all probability* can earn * * * It entails a *prediction* of future events." *Institutional Investors v. Chicago, M. St. P. & P.*, 318 US 523, 540, 542 (1942). Mathematical certainty is not called for, but an *"estimate."* But that estimate must be based on an informed judgment which "embraces all facts relevant to *future* earning capacity and *hence* to present worth" including, of course, the nature and condition of the properties, the past earnings record, and *all circumstances which indicate whether or not that record is a reliable criterion of future performance" Consolidated Rock Prod. Co.*, at 526 (our emph.).

A. The district court's valuation erred in neglecting all evidence of continuance of current trend of increasing traffic and increasing gross earnings.

The trustee expressly contended (II 58; Ex V-7, II 224-226; 51, 63, 64) and the court acted on the assumption that revenue had reached maximum in 1962 (II 387.4) and would not go above $3,124,000 (II 224). In fact the assumption was unwarranted. Revenue has continued to grow steadily, even without effort by the trustee (II 1090), from $1,640,000 in 1958 (II 199) to $3,802,000 in 1962 to $4,779,000 in 1964, latest year in the record (III 274). This growth becomes more meaningful against its background—expansion of the Puerto Rican economy to which the prosperity of the company is directly related, and the shift of that economy to increasing export-import trade (II 242). The company's growth has been confirmed by capture of a steadily growing proportion of a steadily growing market (II 246).

The foundation for the trustee's 1962 valuation was the explicit assumption of "continuing to use the three vessels" on the then "present frequency of sailings" (II 224-5, 657).

This assumption had been already contradicted by the trustee's own words and acts[37] yet it was the premise of the entire approach to the valuation that the current operation was the only reliable factor of future performance.[38] By

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[37] April 1961 - ". . . demands are continually increasing and volume steadily increasing without any special emphasis by the trustee in efforts to develop new business" (II 1090)

August 1961 - Additional vessels of improved design should be acquired in order to handle the increasing traffic and insure continuous service (II 5)

February 1962 - If the present volume of business continues to increase a fourth trailership is needed (II 657)

May 1962 - The trustee has been offered . . . more traffic . . . from Florida to Puerto Rico than the existing three vessels can handle and there is a backlog of merchandise . . . for movement to Puerto Rico" (II 310.1, Petition for Purchase of Vessel)

[38] Q: But if this enterprise were out from under the proceedings, would it? [i.e. would it be appropriate to ascertain the cost of efforts to increase the volume carried southbound in the off peak season, the possible increased revenue from such efforts and the possible increased profits?]

The Court: Well, we are dealing with an organization that is in. Let's assume that it will stay right there and try to get the value. It is not going to get out until it is reorganized.

Mr. Mason: "We are trying to get the value when reorganized".

The Court: "That is of no importance to me. Let's value it as it now exists to determine what should be done in these proceedings." (II 170)

Q: . . . That you would take the historical earning records, that you would examine or determine whether there are reasonably foreseeable factors that might tend to indicate an improvement in earnings or a diminution of expense?

The Court: All these projections into the future are not going to bother the Court. These creditors have waited too long to get their money". (II 192)

Valuation Order: "The only reliable factors are what the debtor is doing now" (II 387.7)

The Court: "There is no future prospects other than what is going on". (III 55-56)

refusing to consider "all circumstances" which indicate whether the past earnings record is "a reliable criterion of future performance," the court put future performance into a strait jacket. Notwithstanding an additional vessel was purchased in June 1962 (II 357) (before the valuation order which found the debtor insolvent), the trustee declined (II 107-8; cf. 1029) to estimate the expected additional income. The court discounted the effect on earnings from this fourth ship because the amount was uncertain and because its purpose was now said to be replacement for anticipated breakdown of the old barges (II 387.7). In fact, the fourth ship was not a replacement but was needed and used as an addition to the fleet (II 865).

The trustee should have put into the record estimates of additional income from such foreseeable and foreseen increases in equipment (see infra p. 53). This was admittedly possible,[39] nevertheless he failed to do so.

B. The district court's valuation erred in rejecting evidence from cash bids higher than the trustee's and his own valuation estimates.

If there were a well-advertised open opportunity to bid under fair conditions for the debtor's entire business and assets, the bids would surely have to be given substantial weight as evidence of minimum worth of the company. But bids were not invited (II 97-8; III 53); and uninvited bidders presented by the committee (II 96; cf. I 189,190,466) were given ample hints that they were regarded as poachers on private domain by being refused elementary and necessary information about the company (supra p. 39). Every plan that received the trustee's approval was a plan that had a job for him. The cash plans did not, and he openly announced his preference for an internal plan over no matter what cash plan (III 660).

[39] Would you be able to make a projection of changes in revenue, expenses and profits under an assumption that there were additional vessels available to the debtor? . . . Could you do it on the basis of the present information in the records of the debtor? "Yes" (II 82; cf III 61-63,150)

In spite of discouragement, U.S. Freight and a Pottharst group, both well-informed and financially responsible (II 159-62,644-7) volunteered bids on their own initiative for the company on an all cash basis. It is readily understandable that their bids were geared to current indications of the court's thinking and proceeded by small increments just topping the trustee's or court's or rival bids each time. Nevertheless the bidding rose briskly from $1,700,000 in April to $2,800,000 in December 1962 while the valuation and Plan II were under consideration[40].

At the confirmation hearing, February 4, 1963, when the cash bids had reached the level of $2,800,000 (II 865), both cash bidders made clear that this was not their top figure (II 880,911,938,939). But the trustee ran them off a week later, by showing them a draft order, later signed by the district court, rejecting the $2,800,000 as "not worthy of consideration" because major creditors would block it – although it was already higher than the court's own valuation (II 880,881)[41]

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[40] Trustee's expert: $1,607,692 (II 125) — cash bidders $1,700,000; 1,800,000; 1,850,000 (II 665,666,668)

Trustee: $2,031,403.72 (II 229) — cash bidders $2,100,000; 2,150,000; 2,200,000; 2,250,000; 2,515,000 (II 681,685,246.2,-.5,-.6,750)

Court: $2,700,000; 2,780,000 (II 312,387.5,885) — cash bidders $2,700,000; 2,800,000 (II 819,865)

[41] The order itself discloses: ". . . major creditors indicate clearly that any such proposal to sell the assets of the debtor to outside interests will not be acceptable." (II 884-5). The trustee had made clear in advance his preference for an internal plan over any cash plan (II 660) and Florida Towing, the controlling creditor in class VI, had announced in open court its intent to block any such plan (II 779).

All the blocking creditors were insiders – Shaffer-Spitzer and Merrill-Stevens votes subject to rejection on grounds of fraud, supra p. 24ff, the Coppedge and Salley (Langston) groups to cutback under § 203 for discount claim-buying in aid of patronage, supra p. 38.

Just because outsiders' bids rhythmically topped the trustee's and court's valuation, it put the court on notice that its own valuation, as well as that of the trustee's expert and the trustee, was, by the test of the market, unrealistically low and required serious reexamination; particularly in view of the valuation of upwards of $4,500,000 already presented by the committee's expert witness, based on this Court's analysis (II, 180, 240-248). All those interested in the estate are entitled to the court's protection, and an alert court would have re-examined both the indicated higher value and the allowance of the contested claims for their effect on the narrow gap between solvency and insolvency. And it should have been a spur to the trustee to encourage the highest possible bid for the benefit of the trust.

C. The district court's valuation was erroneously based on net earnings after wilfully padded current costs.

The court of appeals regarded it as a confirmation of the wisdom of the district court's 1962 refusal to recognize already visible trends of the company's postreorganization future, that the net profits reported by the trustee for 1964 dropped after a rise, 364 F2d at 940-1. This drop in net profits, however, results from some costs plainly juggled. The record shows that notwithstanding an unanticipated rate war (III 127) revenues continued after the 1962 hearing to grow just as the Committee's expert witness had predicted they would (II 249; III 231-2), but that cost increases cut down the net profit. These cost figures, however, are fictions.

In part they rest on a bookkeeping manipulation of reserves beginning in 1962, the year of Plan II, that padded the costs by an average of more than $50,000 per year. In part they reflect milking the profits in favor of Florida Towing, beginning in 1963, by $1000 per voyage or over $100,000

per year, (supra p. 38) the more voyages the more milking as traffic grew, (infra p. 53). In part they consist of refusal to disentangle true operating overhead costs from heavy non-recurring reorganization costs, in an amount that we charged without rebuttal was in the range of $140,000 back in 1961 and can hardly have suffered any material decrease in the audited years 1962-4: refusal to disclose these essential figures is a phase of the trustee's general policy of withholding essential valuation facts, supra p. 39. Detailing all these cost elements in turn –

Reserves: – Beginning in 1962, the year of valuation, the trustee set up new reserves now totalling over $160,000 for the last three years for which audited figures are in the record, 1962-4, or an average of over $50,000 per year. Since they had not been spread back over the long term they constitute a sudden downward jar to reported net income, that does not reflect any increase in operating costs, as the trustee's general manager admitted (II 921-3). The trustee's own CPA was compelled to refuse a clean certificate and has continued to flag them in each report in the record: adding back the new 1962 reserves to 1962 reported profit corrects the reported net earnings for that year to $655,000 (II 891.1; III 283).

Tugboat Contract – Now that TMT's self-propelled trailerships have been foreclosed away, and all sea transportation is by towed LST barges, tugboat hire is the heaviest operating cost, $870,000 in the 1961 figures for Plan II, $1,475,000 in the 1964 figures for Plan III (over 30% of revenue, II 217; III 280). Florida Towing Company, a Coppedge family concern, had done some of this work for the old company and was a minor maritime lien claimant. As discussed elsewhere (infra p. 63), it started as an outsider whose reorganization plan was rejected at the time of Plan I, but it tendered the company a $100,000 loan needed for Plan II, and in both Plan II and Plan III it became an insider with a Coppedge on the new board. In 1963, just after approval of Plan II, its towing contract came up for renewal, and was relet with only a pretense of competition. Florida Towing was given

the contract at an increased rate of $1000 per voyage, although a rival bidder offered to do the work at the old rate.[42]

The lower bid was rejected by trustee and court on the asserted ground that the bidder was himself a potential reorganizer, and that the bidder had no tugs of his own and was therefore "nothing but a broker" (II 946-9, 952-3; III 934-5). One would have thought Florida Towing no better qualified if disinterestedness be the test, since it was itself a power in the reorganization; and surely an underbid by a broker should have put the trustee on notice that aggressive shopping could turn up a principal at a rate cheaper still. In 1965 the Florida Towing contract was renewed at the same rate, this time without even pretense of seeking competitive bids, again over our protest (III 70, 90, 98). In so loading expense by a minimum $1000 per voyage patronage to this insider, the annual added cost to the company, at over 100 voyages per year (III 97), is upwards of $100,000.

Overhead: – In 1961, the year whose figures based Plan II, the composite overhead figure was $283,000 (II 217, 1077); and well before the Plan II hearings we had warned the trustee of his responsibility to break it down (II 1077). By 1964 the figure was apparently up to some $443,000, (III 280: inconsistent rubrics make it not too easy to match figures). In the Plan II hearings the trustee's general manager said he had made this breakdown, but he did not accede to our request to produce it at the hearings (II 73-6). In the Plan III hearings the general manager denied he ever had any such figures at all (III 182-3). No matter which of these two phases of his testimony is the truth, the fact remains that until reorganization costs are dissected out and discarded as we have demanded, the overhead cost figures used by the trustee are improper basis for earnings calculation and therefore for valuation. Taking the committee's unrebutted estimate (II

[42] For the trustee's violation of instruction of the court that he supply to still other responsible bidders a copy of the draft contract to bid against, and the trustee's repellent treatment that ran those bidders off, supra p. 40 n. 36.

1078) of one half, in default of the better figure it was the trustee's clear duty to supply, this is $220,000 of cost padding.

To collect the above three items of cost padding, they are the new reserves at $50,000 per year, the buried reorganization costs at $220,000, and the $100,000 fat in the tug work, a total of over $370,000. Capitalized at the district court's 10X/2 rate (II 387.5)[43] the valuation figures go up by $1,850,000, three times the insolvency gap once the fraud-tainted claims are barred.

D. The district court erred in considering future earnings as based on current high costs in disregard of the trustee's existing calculations of programmed post-reorganization modernization economies.

A further factor in the upward distortion of reported costs and downward distortion of reported net profits is per-voyage cost increases attributable to the reorganization itself. These arise solely from the fact that the reorganiza- has been so protracted that the trustee by choice (I 210, III 30, 62, 143, 145) has not yet put into operation the cost saving measures he has long plannned. On loss of the old company's self-propelled vessels through foreclosure, the trustee continued operation with concededly obsolete and expensive LSTs (I 473, III 62,154). He had to increase his fleet of them to 5, from the 3 with which he was making his 1962 profits (II 225; III 152), in order to serve the constantly increasing traffic tendered him, for under reorganization conditions he could not (or said he could not) finance more modern vessels we had urged him to buy (II 1079-82)

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[43] The court divided by 2 to allow for taxes and multiplied by 10 as a capitalization factor. This conservative capitalization has no record support whatever, since the only record information of the rate at which the market values earnings in comparable industries shows a 13.8 rate (committee's expert, II 246-250); 11.2 rate (trustee's expert rebuttal II 303-4); "somewhat higher than they were two and a half years ago" (SEC offer of proof III 200).

and which he had already programmed in detail to replace the LSTs—but only after reorganization (III 126,138,139, 153-4).

The older these vessels, the more they cost to keep running. The general manager admitted that for the year 1964, whose figures were used by the district court to support his view that rising costs made the company "more insolvent than before", the excess maintenance cost on the two oldest vessels alone was some $150,000:

> "[T]he year '64 required total costs of $249,000 [rect. $259,000—chart, III 78] in shipyards on those two vessels. * * * The normal costs for those vessels, if they were not that old, in that condition, would be between $50,000 and $75,000 to recertificate; leaving an excess cost of $146,000 per year which is chargeable to the fact that the company was not reorganized sooner and those vessels replaced by the new owners, which, no doubt, they would." (III, 30-1)

Thus it is the continuance of the reorganization that has itself aggravated the inefficient high cost operation conditions of the reorganization period, and has prevented achievement of the efficient postreorganization operating conditions with replacement vessels. The trustee has existing plans and figures for these vessels and for their financing and the operating results of their use, which he has projected with business-like detail but kept out of the valuation record:

> "* * * from our studies that we have made, from which we have not made formal plans, we can carry the increased capacity in four vessels that are stern loaders that five vessels as they are now loaded will hold, so we have twenty-five percent increased cargo capacity in a specially designed vessel and improved type of sea-going tug. With these we can come out with costs in which it would be economically feasible to spend two million dollars for each of those vessels." (III 61)

"Q. Mr. Thouvenelle [general manager], when did the trustee or you first begin to make these projections on the basis of this new type of vessel?

"A. When we first started to have trouble with the old ones four or five years ago. * * *

"Q. When did you come to these cost conclusions you have just given us?

"A. Oh, at various times. We have not advanced any formal plans. But we have put enough figures together to know that our conclusions were sound." (III 62; see also II 82, 86)

The new vessels, if the company had had them, "would, by this time, have restored the competitive advantage even though the rates are lower than they were in 1962." (III 139)

To compute 1965 going-concern value on the basis of such high-cost reorganization-period operations in the face of such firm plans for post-reorganization cost savings is an even more stubborn rejection of this Court's case law, supra pp. 42-43, than was the district court's 1962 rejection of the clear trend of traffic increase.

E. The district court erred in not reexamining in 1965 the valuation erroneously made in 1962.

All the defects of the Plan II valuation were compounded in Plan III. Although the court of appeals had not passed on our attacks on the standards applied by the district court, on the erroneous limiting of the scope of inquiry, exclusion of material testimony, allowance of improper compromises in the computation and failure to give weight to cash bids (II 392-94), the district court erroneously concluded that the appellate court had affirmed on those matters. Therefore the district court limited the record, on remand, to events since the altogether inadequate and unsound 1962 valuation (III 66,235,243,266-8). The court reached the trustee's requested finding on this again inadequate hearing, that the estate was "more insolvent" than in 1962 (III 13,266). The court reached this view even though revenues

had grown as the Committee had predicted in the teeth of the trustee's 1962 evidence and the court's express 1962 finding that revenue had reached its maximum (II 387.3):

> [Cross examination of the trustee's general manager by SEC counsel]
>
> "Q Mr. Thouvenelle, notwithstanding the two appeals, one taken by the Stockholders' Committee and the other taken by the Government, and rate cuts and hurricanes and competition, you still managed to increase your volume of business handled, year after year after year?
>
> "A Yes (III, 34).

The court persisted in this view even though substantial new revenue-producing equipment had been acquired out of these earnings as the Committee had predicted it should and would (II 243-4,1081) and even though important operational improvements had been made or were in a concrete stage of preparation.[44] The court also failed to consider the

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[44] That the growth was fairly predictable is reflected in these figures for revenue:

	Trustee's 1962 prediction (II 224)	Committee's 1962 prediction (II 249)	Actual (III 274)
1962	$3,124,000	$3,500,000	$3,802,000
1963	3,124,000	4,090,000	4,356,000
1964	3,124,000	4,775,000	4,779,000

As pointed out supra p. 47 ff, profits were managed and manipulated and do not afford a basis for comparison.

The growth that occurred is reflected in these figures from the successive plan hearings (II 225;230;222;224;III 78;97;145;274):

	Ships	Sailings	Trailers	Revenue
Plan II	3	50	331	$3,024,000
Plan III	5	101½	670	4,779,000

Additional improvements made or in active preparation included:

implications of the paradoxical fact that although it was now said to be "more insolvent" than in 1962, the enterprise was now able to borrow $1,250,000 which it could not do in 1962. Then it was explicitly stated that if the company had to pay the government in full, it could not do so, although it could borrow $500,000 and pay the government 30 or 40 cents on the dollar (II 327, 373).

This loan, we may note parenthetically, was offered by a banking group of which the trustee was director. The loan conditions originally tied the loan to retention of the trustee as management (III 244,266). Investigation of this matter called for by the committee under § 221(3)(4)(5) was denied (III 244-5,266).

From the point of view of the valuation of the company, this bank loan is extraordinary in that, if the bank saw the trustee's figures and believed them, it was lending $1,250,000 payable at $300,000/year plus interest at 6% (in the first year this amounts to $366,750) to an enterprise that the trustee contended in 1962 would earn $206,000/year (II 353) and was now in 1965 even "more insolvent" (III 266). The bank got security it is true, but this was the plainly illusory security of rapidly deteriorating special purpose equipment (II 14-18,101-104,127,223,III 78,174), virtually worthless on a foreclosure and valuable only to the extent that it produced earnings. Since banks do not ordinarily make loans so dangerously improvident, even to assure soft berths

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(a) New model trailers for initiating railroad "piggy back" interchange with railroads—first purchase $100,000 (III 174-5, 286).

(b) Testing of refrigerated trailers (III 308)

(c) Studies for new improved vessels (III 61-63,144-148,233)

(d) Patent application re TMT's lashing system—estimated saving $30,000-$35,000 per year (III 194-195)

(e) Contract service to Navy installation in the Bahamas (III 175-7)

to good friends who sit on their boards, the question must be faced whether the trustee gave the bank a truer picture of the earning power of the company than he has chosen to give the record. If not, this is a repeat of the classic manoeuvre of the eve-of-bankruptcy mortgage.

The court's conclusions, in the face of this evidence, and of this refusal to investigate, and of the persistently incorrect approach, do not reflect the business realism that Chapter X requires.

POINT III - Stockholders victimized by the debtor's participation in stock flotation fraud should have been considered for creditor treatment.

In 1960, albeit reluctantly, the trustee had investigated the committee's 1958 charges of fraud and 1959 charge that Shaffer-Spitzer was Abrams' front. The investigation proved those charges and turned up the new and significant fact that not only had Abrams et al. defrauded the company but as insider financial advisers they had led the company into itself committing a series of stock flotation frauds—unindependent accountant's financial statements, balance sheet inflation by the Wilmington and Bellanca deals (I 261,263-4, 269-70).[45]

A. Public stockholders have a valid claim against the company.

From these facts there could readily be developed the view that under the federal securities laws the company's participation in the stock flotation conspiracy made the company itself liable to innocent stockholders who had bought unregistered stock from Abrams-Shaffer-Erdman, or who bought from third parties in the manipulated market,

[45]The committee later charged additional such stock flotation frauds (II365ff) including the fraud in Maritime Administration discussed in connection with the trustee's failure to investigate, supra, p. 26; continued use of an offering circular no longer true; stockrigging publicity about the Carib Queen. (I 260,261,271).

even without privity with the issuer company. The committee contended that the stockholders were entitled to creditor treatment by reason of those frauds and statutory violations. The first record statement of this position was by the SEC and by the trustee himself in his February 1961 objection to the Shaffer-Spitzer claim.

> "The claim should be disallowed in toto or be subordinated to the claims of *general creditors, including stockholders* who were sold TMT stock in violation of the Security Act of 1933 and the Securities Exchange Act of 1934" (II 1096, our emph.; cf. II 1093).

Because of the special importance of this problem to the SEC, as indicated in the Solicitor General's memorandum in support of our petition for certiorari p. 19 ff., we leave to the briefing we assume the SEC will make any elaboration of the substantive principle here involved, both as to the right of public stockholders to claim against the issuer under the doctrine of the bank receivership cases such as *Oppenheimer v. Harriman etc. Bank,* 301 U.S. 206; and as to the unimportance of privity in federal securities law violations suits under such cases as *Fischman v. Raytheon Mfg. Co.*, 188 F2d 783 (CA2); *Hooper v. Mountain States etc. Corp.*, 282 F2d 201 (CA5); *Texas Continental etc. Co. v. Dunne,* 307 F2d 242 (CA6). We address ourselves therefore to the question particular to the posture of this case, whether the claim was presented too late.

B. The courts below erroneously held the claim presented too late.

In the Plan III proceedings now under review the court of appeals affirmed the district court's rejection of the stockholders' claim without reaching the merits of the claim, on the ground of laches. It held the proofs of claim filed by the committee and by an individual stockholder on behalf of herself and her class both barred by the district court order of February 4, 1958. This order had required proofs of all claims to be filed by April 4, 1958, two months away, except that as to claims "founded upon securities", the bar date was put off

to "the time to be fixed herein within which the creditors and stockholders affected thereby may accept the plan" (147). Holding that the exception in the order contemplated contract claims only, rather than a tort claim or right of rescission, the court of appeals held that the bar date applied in terms and that "no valid reason or excuse is given for the delay from July 1960 [discovery of the claim] until June 1962 [filing of the formal proofs of claim]" and since the liquidation of the claims might have taken years the district court had discretion to refuse to reopen the bar date and to decline to consider the merits. *Protective Committee etc. v. Anderson*, 364 F2d 936, 939-40. The bar order in this case came out of a form book[46] and must be applied to a set of facts which have no form book precedent. If the stockholders' claim is one "grounded upon securities", the bar date has never passed. If not, but the stockholders could reasonably have so understood it, it clearly ought to be reopened. In any case the district court has power to reopen it upon a showing that facts essential to the assertion of the claim were not known at the time the bar date passed in 1958. That is clearly the case where, as here, trustee and district court refused to believe the fraud even worth investigating although insistently urged to do so, until 1960, and the securities law violations were not known until the trustee's investigation and report in July 1960. Reorganization cases decry Procrustean treatment of bar dates. *In re United Cigar Stores Co. of America*, 82 F2d 744, 745 (CA2) Cf. *Comstock v. Group of Institutional Investors*, 335 U.S. 211, 226-228, and dissent at 235. See also cases collected 6A *Collier on Bankruptcy*, ¶ 9.03. Cf also H. Report 1409 (75th Cong., 1st Sess.) p. 46.

Indeed, assuming for the moment that the bar date had passed and that the Committee was barred by laches from obtaining a reopening of it, the substantive issue is of such importance, the effect upon scattered public stockholders of such consequence, and the fairness and equitableness of the

[46] *7 Collier on Bankruptcy*, ¶ 2202

plan so plainly involved, that the district court was bound to raise and consider the questions we brought to his attention, sua sponte, and if they have some measure of validity, to reopen the bar date without our request. *Comstock* supra; cf. *Young v. Higbee Company*, 324 U.S. 204, 214.

1. The appropriate bar date had not yet passed.

Trade creditors or even tort claimants have had particularized transactions with the debtor, which can be and should be stated early under traditional bankruptcy doctrines so that these claims can be totted up. But public security holders are on a different footing and are traditionally treated differently. The fact that they are scattered and usually ignorant of their rights and of the procedures for defending them was one of the reasons that led to the Chapter X reforms and to the emphasis there on protective committees to act for security holders. (aboye p. 21). It would be absurd to compel the committee to comply at this stage with the formal requisite of a proof of claim that it identify each stockholder by name, address and certificate number for purposes of a securities law claim any more than for a claim to a piece of the equity. Debenture holders' claims are computed on the basis of a maximum amount estimated outstanding, whether or not they have filed, for purposes of a plan; and so they were here (I 47-8). Stockholders' rights to recover what they paid in the market are likewise adequately computable to a maximum for working purposes by recourse to transfer records and to readily available quotation sheets. The bare possibility that the maximum so set might be imprecise is no reason not to set it at all. Hence until the right asserted by the committee is vindicated in principle on the crucial facts common to all public stockholders, there was and will be no point to putting either the committee or the estate to spending money to encourage and perhaps mislead scattered stockholders into the difficult task of documenting rights not yet established. In the light of these considerations, the construction of the bar date order as not barring the claim better serves the purposes of

the statute. But if the bar date applies, then imperative considerations of equity require that it be reopened.

2. The finding that the claim came too late was erroneous in the absence of hearing.

The formal proofs of claim were filed in June 1962, and the Plan II approval order rejecting them was filed in July. But there was no pleading response at all to the committee claim, and the trustee's motion to strike the individual claim was never noticed for hearing, so that the district court disposed of both ex parte (II 4,368,370). The question whether the 1958 bar date should apply to these 1962 proofs of claims since it could not be decided against the stockholders merely by matching dates, was a question of fact, of laches. This the court of appeals recognized even in deciding against the stockholders on the point:

> "No valid reason or excuse is given for the delay from July 1960 until June 1962. To allow the filing of additional claims of an unknown number of stockholders, which by their nature might have required years to liquidate and which might have delayed indefinitely the formulation of any plan of reorganization, would have been extremely prejudicial to the creditors." (364 F2d, at 940)

In this quoted treatment of the laches question there are two errors, one of fact and one of law.

As to fact, the court here fails to mention that long before the filing of the June 1962 formal proofs of claim the committee had picked up the trustee's June 1960 disclosure of the facts and his February 1961 indication of the basic theory of the claim. This was explicit in the committee's Statement of Position, presented in March 1961, i.e., before the appeals from Plan I had been disposed of. It recited the claim and included an application for extension of the bar date: but it was rejected as premature, with leave to file later (II 861,962,1039).[47] The trustee did not extend

[47]The court of appeals decision on Plan I, 292 F2d 455, had not yet come down; and this Court's denial of certiorari to Shaffer-Spitzer

his statutory invitation for plan suggestions under § 167(5,6) until February 6, 1962 (II 659), shortly after certiorari on Plan I was denied. Then another unequivocal announcement of the committee's assertion of the claim took place in February 1962, in timely response to the trustee's invitation.[48] The court of appeals, in criticizing the committee for filing *too late* in June 1962 overlooked not only the February 1962 Suggestions but also the March 1961 Statement and application for extension of bar date, a document rejected by the district court as filed *too soon.*

As to law, the court of appeals in the quoted passage turns the laches on the observation that the individual claims "might" have taken years to liquidate and so might have prejudiced the creditors by preventing the formulation of a reorganization plan. The committee's proposed amendments to the plan (II 1087) had asked the district court to set aside a maximum block of new common stock for old stockholders, a simple and practical way of providing for recognition of the claim while leaving it to the stockholders to fight out later their total overall participation within this maximum and which of them should get what within that total, all without interference with the immediate issuance of new common stock to acknowledged general creditors. This is the commonplace machinery of issuing stock subject to a maximum dilution in favor of someone else, that may or may not ever come to pass.[49] Laches, it is elementary,

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on Plan I, 368 U.S. 956, did not come down until January 1962. Until that date Plan II development necessarily marked time.

[48] Suggestions for the Formulation of a Plan, (II 1083, filed Feb. 16, 1962). Our Amendments to the Plan (II 1090, filed June 18, 1962); Objections and Amendments to Cash Plan (II, 1087, filed June 18, 1962), were filed at substantially the same date as the proofs of claim: they indicate the variety of our assertions of the position.

[49] Suggestions for working out the mechanics by which liability in principle is determined first and intervention of individual claimants permitted later are supplied by *Union Carbide & Carbon Corp. v. Nisley,* 300 F2d 561(CA 10); *York v. Guaranty Trust,* 143 F2d 503 (CA2); *Derdiarian v. Futterman Corp.,* CCH Fed Sec L. Rep. ¶ 91.575 (SDNY, 1965).

requires both a finding of unjustified delay and a finding of detriment. We submit that in view of the earlier several presentations of the claim there could be no fair claim of filing delay; and that on the facts of the committee's proposal there need be none of the detriment by hypothetical future delay envisaged by the court of appeals. But both these questions are questions of fact, and deciding the issue of laches without opportunity to have them weighed at an adversary hearing on notice, this Court has made plain, is error of principle for which it will reverse a court of appeals:

> ". . . there was never an opportunity for Czaplicki to introduce evidence to justify the delay * * * [N] or has there been opportunity to prove * * * that the delay has in no way prejudiced the respondents. These are questions on which the parties should have been allowed to present evidence. The present record is inadequate to justify a holding that this action was barred by laches." (*Czaplicki v. The Hoegh Silvercloud*, 351 U.S. 252) 533-534.

POINT IV - The trustee's conflict of interest invalidates the proceedings and taints the reorganization plan.

A. Trustee independence is the basic assumption of Chapter X reorganization.

One of the reasons for the enactment of Chapter X was to remedy the abuses resulting from "friendly trustees" (Sen. Rep. No. 1916 on H.R. 8046, 75th Cong., 3rd Sess. 21-22(1938). "* * * The independent trustee is the key to real reform. In comparison the other reforms are secondary" (SEC Comm'r Douglas, Hearings before H.R. Committee on Judiciary, on HR 6439, p. 177 (1937).

The independent trustee makes possible impartial investigation of pre-reorganization misconduct, impartial consideration of alternative plans, and impartial scrutiny of the allocation of control and the affiliations of new management. Only through an impartial and independent trustee can the court be in a position to exercise an "informal judgment and to afford a critical scrutiny and supervision of the estate

at all times" (H.R. Report No. 1409, 75th Cong., 1st Sess., 43 (1937).

"As a general principle, the trustee and his attorney engaged in the conduct of the reorganization proceeding should be free of the slightest personal interest which might be reflected in their decisions concerning matters of the debtor's estate or which might impair the high degree of impartiality and detached judgment expected of them during administration." (6 *Collier on Bankruptcy* p. 2003 (14 ed., 1947).

Sec. 156 of the Act requires that a reorganization trustee be "disinterested." § 158(4) provides that a trustee is not "disinterested" where it appears that he has, ... for any reason an interest materially adverse to the interests of any class of creditors or stockholders."

B. This trustee has acquired a personal interest in the reorganization plan sponsored.

Formulation of three successive plans under his trusteeship has been followed by his designation each time as president and director. Ever since the "mutually satisfactory conclusions" (I 40) with Shaffer-Spitzer in Plan I which resulted in the trustee's becoming president, the trustee has had a personal stake in the reorganization: a management contract and stock options, firmly committed or transparently understood. Under Plan I, he had only one seat out of 9 on the board controlled by Shaffer-Spitzer. Under Plans II and III however, the trustee and his staff will have 3 places out of 7 on the board and for most management decisions will be in practical control of the reorganized company since 2 places are filled by his patronage beneficiaries and the last 2 by the protected accused creditor Merrill-Stevens.

Plans II and III are additionally predicated on the trustee's continued connection with the reorganized company. Loan commitments were concededly essential to plan feasibility (Plan II, $500,000, II 314,331; Plan II, $1,250,000, III 12, 25). In Plan II, a tie-in loan, offered by Florida Towing, a patronage beneficiary, and one by a banking group of which

the trustee was himself a director, were explicitly conditioned on his management (II 314,319-22,331; expurgated 748, 749). In Plan III, a larger loan was offered by a member of the trustee's banking group. Although the Plan II tie-in condition was in less explicit words, it was clearly understood (III 24, 244). The trustee admitted that he had made no effort to get loans from independent sources, free of this condition (II 322).

C. The trustee's personal interest in the reorganization plan resulted in conflict of interest that taints the plan.

"Equity tolerates in bankruptcy trustees no interest adverse to the trust. This is not because such interests are always corrupt but because they are always corrupting" *Mosser v. Darrow*, 341 U.S. 267, 271. For this reason, we join the SEC in believing that a prophylactic rule is called for, barring trustees from aspiring to major office in the reorganized company.

On the facts of this case however, we urge that even if this Court should not sustain the absolute bar, it is utterly clear that this trustee on the facts of this reorganization cannot serve and did not serve the estate and the parties evenhandedly, free of bias from the expectations and understandings and hopes he entertained of support from certain major creditors, and free of interest adverse to the stockholders.

The trustee has consistently chosen reorganization plans that favor him. In 1958-59 the choice was between the Shaffer-Spitzer plan that retained him as president and the Florida Towing plan which did not (I 113, 183; 114); he argued against Florida Towing and adopted as his own the Shaffer-Spitzer plan (I 117, 135, 163).

In 1962-63 the choice was between an "internal" stock plan which similarly offered him a job, and a cash plan which did not. The trustee argued against the cash plan and the bidders desisted. This time Florida Towing was an ally, and through claim-buying, was enabled to cast a substantial vote in favor of the "internal plan".[50] It was rewarded with a

[50] For Plan III, Florida Towing's vote was essential: 70% of class 6, a blocking vote, plus 11% of unsecured claims.

place on the board and a sweetheart towing contract now running to $1,500,000/year.

The trustee's choice in each instance was self-serving. We cannot prove that he was influenced only by his personal advantage, but - - -

". . .the incidence of a particular conflict of interest can seldom be measured with any degree of certainty. The bankruptcy court need not speculate as to whether the result of the conflict was to delay action where speed was essential, to close the record of past transactions where publicity and investigation were needed, to compromise claims by inattention where vigilant assertion was necessary, or otherwise to dilute the undivided loyalty owed to those whom the claimant purported to represent," See also *Woods v. City Bank Co.*, 312 U.S. 286, 368, which denied compensation to a fiduciary in a Chapter X proceeding where a conflict of interest existed, though no fraud or unfairness was specifically shown to have resulted.

Where the conflict exists, there need be no speculation whether the result was

- to close the record of Merrill-Steven's past transactions where investigation was needed.

- to compromise the Shaffer-Spitzer and Merrill-Stevens claims where vigorous assertion of counterclaim was necessary.

- to delay or abandon suits where speed was essential to prevent tolling of the statute of limitations.

- to bestow insider contracts where competitive bidding would have been more economical.

- to delay or refuse information until outside investors give up in disgust where encouragement might have benefitted the estate.

The district court here recognized that the trustee, faced with a choice between the "internal" plan which offered him employment and a cash plan which did not, "would be perhaps inclined to lean to his employment" (II 332)

but failed both at that point or generally to hold the trustee to the high standard required by this court in *Wolf v. Weinstein*, 372 U.S. 633, where a severe remedy was found necessary:

> "***one who exercised control over a reorganization holds a post which might tempt him to affect or influence corporate policies—even the shaping of the very plan of reorganization—for the benefit of his own security holdings but to the detriment of the Debtor's interests and those of its creditors and other interested groups".

Though this language applied to the president of a debtor in possession under Chapter X who had traded in the debtor's securities, the reasoning is at least as applicable to a reorganization trustee who trades in undertakings of future employment. A trustee who, while trustee, considers or is approached with the suggestion that he become the president must make a choice. He must either in clear terms reject the suggestion and remain as trustee—or he may entertain the suggestion and resign as trustee for he can no longer be impartial.

POINT V - The reorganization has been conducted in substantial disregard of the statutory function of the SEC.

Chapter X sought to abate the evil of equity receiverships by vesting in the district judge new opportunities and new duties to protect the scattered public investors from insider exploitation in reorganizations. Scarcely less crucial to Chapter X effectiveness than the independent trustee as the reorganization judge's dedicated investigator and reporter of reorganization facts both prospective and retrospective, is the SEC as the reorganization judge's expert adviser. The SEC gets automatic notice of all steps in all Chapter X cases, § 265; with the reorganization judge's approval it becomes as here (I 25) a party to the case for all purposes except initiating appeals, § 208; and in any case with over $3,000,000 debts as here the judge must (and in smaller cases he may) submit the reorganization plan to the SEC for examination

and report before he approves it for submission to vote of the parties, § 172. We have noted in passing that the SEC's views were much like those of the committee on many issues of the case; and on no major issue at any stage initial or appellate did the SEC take a position in opposition to that of the committee. But the point of particular importance is that the SEC's advisory reports had specifically warned the district court against each of the major errors we complain of here.

The SEC's reports criticized the spurious "compromises," the retrospective valuation technique, the trustee's lack of independence, the rejection of the stockholders' creditor claim without hearing.[51] More important still than the fact

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[51] "In estimating the foreseeable future earnings, weight must be accorded to past earnings only insofar as they are indicative of future earning power" (SEC Advisory Opinion on Plan II (II 729).

"The trustee's approach to earnings of the Debtor as a basis for valuation as a going-concern was unduly restrictive. The record of the valuation hearing clearly indicates that the trustee has proceeded upon the erroneous basis that, for purposes of arriving at a going-concern value, the Debtor is assumed to remain in reorganization, and thus is to be valued 'as it now exists,' rather than 'when reorganized'. The effect of this narrow view was to restrict the development on the record of foreseeable possibilities of increasing revenue or reducing expenses, and confined the projection of earnings to a consideration of only the status quo." (II 733)

"The demonstrated need for the additional vessel highlights the trustee's failure to give effect to reasonable foreseeable expansion of the Debtor's business." (II 734)

"Unless the potentialities of expansion of the Debtor's business are properly explored for the purpose of valuation, we have no adequate basis upon which to test the sufficiency of the cash offers. Finally, although we are not prepared to state what the Debtor's enterprise is reasonably worth, the facts thus far developed provided no justifiable basis upon which to conclude that the stockholders have no equity in the Debtor. We conclude that this record does not contain adequate and reliable evidence of value for the purpose of determining the fairness of the plan." (II 735)

that the SEC reported these errors before confirmation, each of its reports rests on some 25 pages of fact analysis far more detailed than that of any judicial opinion in the record. (II 722ff.;III 215ff.) Each report points to specific

"In light of the trustee's report, the treatment of the Caplan mortgage is not fair or proper. There is nothing in the record to justify the trustee's retreat from this prior position in his report." (II 739)

"Both plans deny stockholders participation on the assumption the Debtor is insolvent, while at the same time effecting compromises allowing some $2,000,000 of seriously contested claims. Since the effect of both plans is to exclude the stockholders on an inadequate valuation record, and in the light of the treatment of the Merrill-Stevens claims and the Caplan mortgage, neither plan is fair and equitable." (II 741)

"The independence and impartiality of the trustee is the very essence of the reorganization process under Chapter X, and must be strictly maintained throughout the proceeding. The prospect of the trustee obtaining a remunerative position with the reorganized company after termination of the trusteeship tends to impair the disinterestedness required of him as trustee. In the course of the proceeding the trustee is called upon to make many decisions and recommendations that are of substantial importance to the reorganization, such as the type of plan to recommend, the prosecution or settlement of claims, and many other matters. In all of these, it is essential that the trustee maintain complete impartiality, uncompromised by any personal interest in the outcome of the reorganization." (II 743)

"In view of the inadequacy of the record, there is no reliable basis upon which to resolve the question of valuation. While the fair and equitable standard does not preclude a proper compromise of claims, the treatment accorded by the plan to the Caplan mortgage and the Merrill-Stevens claim represents no genuine compromise." SEC Advisory Opinion on Plan III (III 235)

"Whether or not such liability [to public stockholders] can be demonstrated depends upon proof of facts which the Court did not permit the Stockholders Committee to present." (III 238)

"The record does not warrant a finding that the plan is fair and equitable in view of lack of adequate evidence as to valuation; the allowance of seriously disputed claims without hearing and the summary rejection, without hearing, of the stockholder claims for fraud." (III 242)

items of evidence in the record on which the SEC conclusions rest. These views of the SEC have particular importance by contrast with the analysis used by the court of appeals in its affirmance of Plan III notwithstanding its stated recognition that the district court had been in error in treating as approved law of the case all those features of Plan II embodied in Plan III.

We need not dwell on obviously rhetorical makeweights in the court of appeals opinion, although we deem them patently erroneous. The assertion as to Shaffer-Spitzer and Merrill-Stevens that–

> "The persons most directly affected by those compromises were other creditors, and it is significant that not a single creditor has ever complained of either compromise" (364 F2d at 941).

is one such error. Even though only a trivial fraction of the creditors objected (III 324,326), this Court holds that overwhelmingly heavy acceptance by creditors will not cure a plan in conflict with the basic Chapter X requirement of fairness. *Case v. Los Angeles Lumber Prod. Co.*, 308 US 106. The now vacated Shaffer-Spitzer Plan I, it will be recalled, was also based on a "compromise" to which not a single creditor failed to acquiesce. I 40,42-43.

Likewise the court of appeals' dismay at the inordinate length of the proceedings:

> "This nine-year-old litigation must at long last be brought to an end" (364 F2d at 941).

cannot fairly militate against the stockholders. Three years were wasted before Plan I was finally set aside for failure to heed the committee's warnings against Shaffer-Spitzer. It took two years more to vacate Plan II for the erroneous district court ruling on government priority, a matter on which the committee took no sides. The committee, because its financial means are limited, has even more reason to deplore the delays brought about by the trustee's failure to follow the plain mandate of the law. It should hardly require even reminder citation that speedy injustice becomes no juster

for being faster. Had the court of appeals decided Plan I or Plan II on the issues raised by the committee, either the stockholders would have been long buried and the case over, or the trustee would not have taken license in Plan II and the district court in Plan III to repeat the errors that provoke the present Plan III appeal.

The basic ground for the court of appeals' treatment of Plan III was not these makeweights. It pitched the affirmance, rather, on the standard appellate doctrine of the presumption of correctness of trial court action, as applied to both the insolvency finding and the refusal to consider stockholders as creditors, which are the operative rulings that exclude stockholders from the reorganization.

As to setting a bar date and finding the stockholders in laches on asserting their creditor claim, the affirmance was on the ground that this was within trial court "discretion," 364 F2d at 940. As to insolvency and the compromises of creditor claims in the face of fraud, the affirmance was on the ground that the insolvency finding was not demonstrated "clearly erroneous;" at 941. We think that we have shown above, in the specific Points devoted to those matters, that the rulings complained of passed the traditional borders of the harmless error doctrine. But in any event, in a Chapter X case the district court's findings do not come to appellate review clothed with the heavy presumption of regularity accorded to most trial court action. When the SEC exercises as here its statutory option to participate in a reorganization by way of appearance, advisory reports, and joining in appeals, the shoe may be on the other foot. As the Second Circuit put it in *Conway v. Silesian Amer. Corp.*, 186 F2d 201, at 202-203 (CA2), where the presumption of trial court regularity was unsuccessfully urged in support of approval of a compromise plan the SEC had found—as here—unfair:

> "But we are not justified in thus oversimplifying this difficult problem, so much more one of forecasting the future than of restating the past. Naturally care-

> ful consideration is due the conclusion of the able district judge who has had this lengthy reorganization so long under his control. At the same time we cannot overlook the fact that the governmental agency charged with substantial responsibility in the premises, the Securities and Exchange Commission, had made an extensive investigation resulting in a detailed and helpful report with *a reasonable conclusion which the trial judge has rather summarily rejected.* If the considered findings of this agency with so much better facilities for investigation than those possessed by either this or the trial court, are to have any force beyond their initial impact below, then we think that they will *largely offset the usual presumption accorded a decision of first instance.* Otherwise much of the statutory purpose in creating an expert body for the consideration of technical problems will be set at naught. Compare 6 Collier on Bankruptcy 7.30, 14th Ed. 1947. We have elsewhere stressed the importance of due regard for Commission findings, Finn v. Childs Company, 2 Cir., 181 F2d 431,438; and we are clear that here, too *we must give weight to the detailed evaluation of the facts made by this reliable and experienced public agency and to the conclusion reached, even though this was not accepted by the trial judge".* (our emph.)

See also on the counterbalancing effect of the SEC views, *Ashbach v. Kirtley,* 289 F.2d 159 (CA8); *Scribner and Miller v. Conway,* 238 F2d 905 at 907 (CA2); *In re Solar Mfg. Corp.,* 215 F2d 555 at 562 (CA3); *Chicago & West Towns Rys. v. Friedman,* 230 F2d 364 (CA7).

We noted at the beginning of this Point that Chapter X gave the district court, sitting in reorganization, new specialized expert assistance. The SEC's reports are advisory. We do not suggest that they bind the court, but they should guide and enlighten the reviewing court even if and perhaps because the reorganization court has rejected them. Where the reorganization court has failed to make crucial investigations required by the statute, has acted precipitately without

hearing any evidence on the fact of laches, and has misweighed the legal effect of valuation evidence on a record that excluded essential evidence on the fact issue of insolvency, all in violation of plain teaching of this Court; where, moreover, the SEC has pointed out in detail not only the particulars of the errors but also the incalculable overall blight cast upon the proceeding by the unindependent trustee,[52] we submit that the reorganization court's errors may not be saved as within such routine ideas as "discretion" and "not clearly erroneous." Under those circumstances, we submit, it is the responsibility of the reviewing court to face up squarely to the major errors alleged, weigh them in the light of the statutory policy that the SEC as the statutory expert says has been nullified, and enforce that policy.

CONCLUSION

We grounded our petition for certiorari largely in the failure of the court of appeals to give guidance to the distrct court for the curbing of the trustee, whereby that court and its officer were encouraged to treat as approved any points on which the court of appeals failed specifically to reprimand when it vacated the first two plans. Because we have complained of so broad a range of interlocking and cumulative error, amounting indeed to an effectively total

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[52] SEC advisory opinions are quoted supra p. 66 n. 51. Additional objections include:

Plan I	SEC objections to approval I 123
	SEC objections to confirmation I 169
	SEC objections to creditors' petition I 197
	SEC objections to consummation I 216,219,231
Plan II	SEC objections to confirmation II 757,862,874
	SEC objections to consummation II 889
	SEC motion to stay consummation II 979
Plan III	SEC objections to confirmation II 325

disregard of the major protections of Chapter X, reversal on one or a few of the available narrow issue errors will not serve for guidance in this reorganization, or in others. We have selected from the broad range of error in this reorganization the four critical errors which deflected the past course of the reorganization: those we presented as the Questions that opened this brief. If they are answered in the spirit of Chapter X, the reorganization court will be required to let the available facts on the stockholders' alleged past laches and on the company's past and present and future, to come into the record and be informedly considered; it will be made plain that the reorganization must be rid of the trustee who has kept so many of these facts out of the record and has demonstrated his overall lack of independence. Curative steps of detail—e.g., the review of the towing contract and the compromises, the reinstatement of the discharged committee, putting an end to the deliberate suppression of facts—all this may then be reasonably expected to fall into place.

Respectfully submitted

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